MAINTAINING COMPETITION

REQUISITES OF A GOVERNMENTAL POLICY

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BY

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FOR GERTRUD

PREFACE

A quarter of a century ago Beatrice and Sidney Webb published a book under the title *A Constitution for the Socialist Commonwealth of Great Britain.* This was an endeavor to provide an organizational blueprint and a policy statement as to what would be involved in establishing socialism in the specific setting of Great Britain at that time. It differed from previous works on socialism by descending from the level of abstract principles and ultimate goals to a discussion of proximate objectives within a given environment and techniques for achieving those objectives.

Although the system of competitive private enterprise has been a standard for the appraisal of economic phenomena for more than a century and a half and, to varying degrees, has been the basis of the policy of the major industrial nations throughout most of that period, there has been no similar attempt to describe the content of a competitive policy. During the earlier part of the competitive era attention was directed toward removing repressive governmental controls, but spokesmen for the competitive philosophy used generalizations so broad that even the writers formulating them would certainly have modified their proposals had they been given administrative responsibility for carrying them out. No state and no exponent of political economy has ever seriously proposed that there be no governmental activity of any kind except that devoted to the protection of property and the enforcement of contracts. More recently, the comprehensive formulations of economic policy have been attempted by persons who desired to move away from the private enterprise system, while supporters of private enterprise have limited themselves to piecemeal proposals. We have been told how to destroy the competitive system, but not how to maintain it.

The purpose of this book is similar in aim but opposite in direction to that of the Webbs' book. It is to set forth the content of a policy designed to maintain the competitive system within the United States.

The setting of the discussion is the twentieth century in the United States of America. The content of the competitive policy and the difficulties involved in achieving competition have been envisaged,

not as logical abstractions, but as aspects of our own particular economic and cultural complex. Similarly, in discussing law and administration, the basic political organization of the United States has been taken for granted. In defining objectives, for example, the boundary between the policy of competition and the policy of state regulation over transportation has been treated on the basis of a railway system like that of the United States and on the basis of regulatory methods like those of our own transportation laws. Similarly, in discussing proposals to make competition effective, it has been taken for granted that these proposals must develop in a political system characterized by division of powers between Federal and state governments, the supremacy of Federal law within the limits of a written constitution, a bill of rights, vigorous judicial policing of the constitutional system, and a functional division of powers within the Federal government. Thus limited by a particular environment, this book does not pretend to indicate either the proper boundaries of a competitive policy or the proper methods for achieving competition in some other country, or, for that matter, what would be appropriate in the United States one hundred years hence. It is hoped that what is lost in universality may be gained in relevance.

The focal points of attention are the character of a governmental program that would be appropriate to the maintenance of competition and the nature of the economic and administrative difficulties which would necessarily be encountered in carrying out that program. Thus the discussion proceeds at the technical level. It is concerned with the formulation of economic objectives and of administrative devices capable of attaining those objectives. It is not concerned with political prognosis. Admittedly, neither the policy of maintaining competition nor any other broad policy can be successfully executed unless it has adequate political support; and it is to be expected that a program as broad and complex as is here suggested must encounter the political difficulties of organized opposition, inadequate understanding, and sheer inertia. Nevertheless, there is no need to attempt here to appraise the size of these difficulties or the possibility of overcoming them. In political affairs, the assertion that a program is politically impossible is the standard refuge of a man who has decided not to fight for it, just as the assertion that a program has broad popular support and cannot fail is the standard encouragement offered to those who undertake the fight. Pessimistic and optimistic predictions alike should be taken as symptoms of the personal intentions of

those who make them, not as serious analyses of the environment. Even party campaign managers, with their many sources of information, habitually go wrong in forecasting the results of elections. A healthier attitude for a citizen is to determine what he wants and how it can be attained, to join others who seek the same goal, and, in Washington's words, "to leave the event in the hands of God."

The author owes a debt of thanks to Ruth Blaisdell and Paul Cohen for their research on this project in finding illustrative material, preparing and verifying footnotes, and increasing the accuracy of the text. Valuable suggestions were received from a considerable number of persons who graciously read the manuscript, notably: Robert A. Brady, J. M. Clark, Robert B. Dawkins, Peter F. Drucker, Frank A. Fetter, Richard B. Heflebower, Dexter M. Keezer, Edward S. Mason, Fred I. Raymond, Robert P. Terrill, Floyd L. Vaughan, Raymond Vernon, Myron W. Watkins, and Frederick V. Waugh. As a result of these suggestions, many parts of the argument have been improved and many inaccuracies and exaggerations eliminated. However, no one but the author carries any responsibility for the final version.

The manuscript was prepared from 1945 to 1947 while the author was a professor of economics at Northwestern University. It was complete and awaiting publication before he returned to Federal employment. It does not purport to express the views of any government agency, nor has any government agency reviewed it or in any way taken responsibility for what it says.

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I. THE OBJECTIVE

THE PURPOSE OF this book is to describe the lines of governmental policy that are appropriate to the maintenance of effective competition in American business. To formulate such a program one must examine the anticompetitive forces that are at work and determine how they may be checked or destroyed. This has been attempted.

The starting point of the inquiry has been an assumption that competition should be preserved. Of course this idea is open to challenge and can be defended only on the basis of an analysis of the performance of a competitive system as against the probable performance of various possible alternatives. The issues relevant to such an inquiry are too large and the evidence is too copious to be discussed parenthetically in a work upon another subject. Hence this book deliberately takes ends for granted and is limited to a discussion of ways and means. In this chapter the grounds for the competitive policy will be explored only to the extent necessary to define the objective, not to justify it.

In preserving competition, as in maintaining the health of any other major part of our social institutions, there is need for action, not by government alone, but also by private individuals and privately organized groups. The competitive spirit can break through an anticompetitive governmental structure, and conversely a pervasive refusal to compete or to organize business along lines appropriate for competition might be sufficient to defeat a governmental policy of fostering competition. Nevertheless, the government is the source of our commercial laws and of our broader and more self-conscious economic decisions. Except where the ground swell of private behavior is strong and sustained, governmental decisions are likely to determine the result. This essay is restricted to a description of what government can do or induce others to do. It ignores the many things that can be done by other means.

The competitive system which, it is presumed, the government should try to preserve is not that perfect and universal competition that exists only in the writings of certain economists. Rather, it is the competitive element of a mixed economic society that has long con-

tained, and, if competition is preserved, will still contain, large amounts of government control, wide differences in the power of business units, substantial obstacles hindering access to markets, monopolized activities under public sanction, and various types of agreed action. A considerable body of economic literature defines the idealized regime of perfect competition. But there is no similar consensus as to the scope and significance of the competitive elements of a mixed economy. For this reason it is necessary to begin by being precise about the nature of the competition that the government may reasonably try to preserve.

Competition necessarily takes place within the limits of certain rules of the game established by law and custom. These rules provide a setting within which commercial intercourse is carried on. They define a structure of property rights, not only in tangible things, but also in intangibles such as trade-marks and trade names and benefits which are to accrue from contracts. They set up methods by which contracts may be made and property rights exchanged. They establish a nomenclature for commercial transactions, business relationships, and types of business enterprise. They punish misrepresentation and fraud; exclude from the market types of commodities that are injurious to health and safety; set standards of identity, substance, or performance for commodities and services; and forbid many types of behavior regarded as antisocial, such as child labor, pollution of rivers, price discrimination, and the flotation of securities without including specified information in a registration statement. To change the rules of the game would be easy—indeed, many such rules are recent and some are highly controversial; but it is inconceivable that a commercial system could operate without a substantial number of them.[1] Yet it is clear that each rule outlaws certain types of competitive behavior and that some rules enforce uniformity of action by all who compete. It is sometimes difficult to decide whether a specific regulation should be regarded as a rule appropriate to the competitive game or as a measure which is antithetical to competition. In general, however, rules of the game are designed to direct competitive behavior into desirable channels without reducing the intensity of competition, whereas anticompetitive measures are designed to make competition less intense and thereby to increase the gains of traders on one side of the market.

It would be incorrect to infer that because the rules set limits for competition their scope should be minimized. Gaps in the rules per-

[1] *Cf.* Frank A. Fetter, "The Truth about Competition," *Annals of the American Academy,* January, 1933.

mit various forms of wasteful, questionable, and objectionable behavior, such as manipulation of corporate securities and sales tactics based upon exploitation of the ignorance of buyers. When the rules are too lax, the competitive game is played by undesirable means and produces undesirable results. When they are too tight, desirable activities are forbidden and experiment becomes difficult. It is possible for the results and hence the social usefulness of competition to change appreciably with changes in the rules.

In a competitive system the rules of the game should be like those that govern a competitive sport: that is, while they set limits within which the play must take place, and in doing so necessarily affect the character of the play, they should allow choice among a large number of alternatives, including all those that make for a good game. In a system that is not competitive, the scope of the rules of the game may be so increased that few alternatives are left for the players. In other words, the rules may become prescriptive instead of prohibitive and the system may become state-managed rather than competitive. Within wide limits, however, competition can remain vigorous regardless of the exact content of the rules which circumscribe it. Although modification of the rules is likely to alter the usefulness of competition, such modification need not substantially affect the vitality of the competitive process itself.

This essay cannot include an analysis of property systems and commercial regulations broad enough to provide a basis for recommending the most satisfactory rules of the game. Accordingly, it will assume the propriety of most parts of the laws of property and contract and of most of our economic police regulations. It will ignore the need for relaxing or revoking certain rules and for tightening or adopting others. It will discuss modification of existing rules only at points where the effect of the rules is not merely to prescribe forms and set limits for competitive action but also to thwart the competition that supposedly remains permissible.

For example, trade-marks are supposed to identify the origin of goods, thus enabling buyers to purchase from persons whose past service has been satisfactory. The comparative merits and proper relative scope of trade-marks and publicly established systems of grading and labeling products as guides to buyers are not relevant to this discussion. The absence of impartial and detailed information about goods may be a source of waste, but it does not in itself impair competition. However, trade-marks may have anticompetitive aspects. If

rights to a single trade-mark can be divided among several enterprises by agreement, the division may not only reduce the usefulness of the mark as an indication of the source of goods, but may also provide a means by which each of the participating concerns confines itself to those market areas and types of product for which it has exclusive control of the mark. If the laws place no limit upon such allocation of markets, trade-marks may jeopardize competition, although this is no part of their ostensible function. Rules of the game that have such results either have been ill designed for their purpose or else conceal an anticompetitive purpose under a mask.

In a competitive system, moreover, there are substantial areas that are deliberately made exceptions to the general rule of competition. These exceptions may take several different forms. Particular types of conduct, such as the exploitation of new inventions, may be undertaken on the basis of monopoly even though competition may be expected in closely related types of conduct. Particular commercial dealings, for example those between employer and employee, may be organized on some basis other than competition, such as collective bargaining between groups on opposite sides of a market. Exceptions such as these seldom go so far as to destroy all vestiges of competition, even within the excepted area; but they substitute a noncompetitive for a competitive process in some or all of the more important decisions. They usually provide safeguards for the legitimate interests of the persons immediately concerned which replace the automatic safeguards of competition. When well considered they also provide safeguards for broader public interests.

The existence of such exceptions is not necessarily a threat to the vigor of competition in other parts of the economy. Indeed, exceptions are inevitable, not only in the case of so-called "natural monopolies," in which peculiar technological conditions or market relationships make competition inappropriate, but also in fields where competition is thought to be inevitably one-sided and hence unduly severe in its effects upon one side of the market. Exceptions are probable where anticompetitive political pressures are especially strong and where the traditions of competition are for some historical reason especially weak. Even exceptions that are improvidently made need not seriously injure the effectiveness of the competitive policy so long as they are not numerous. However, a threat to the competitive policy may appear if exceptions become too common. It would be possible to convert a competitive economy into a noncompetitive one by extending the ex-

ceptions to competition until in the aggregate they came to determine the characteristics of the economy as a whole. For this reason it is appropriate under a competitive policy to resist exceptions, to demand that the need for each one be proved, and to keep the total number small.

Since an exception to a policy is grounded in unusual circumstances, the quality of the exceptions to the competitive policy of the United States can be appraised only through an examination of them case by case. Space and time do not permit so systematic an undertaking in this essay. Only a few major exceptions will be discussed, and mistaken exceptions will be identified as such only where the evidence appears to be strong.

The vigor of competition depends not only upon keeping down the number of the exceptions but also upon careful determination of the boundaries of each of the excepted fields of activity. Ill-conceived exceptions, like ill-conceived rules of the game, may impair competition where it supposedly still prevails. In some cases, the rule of competition is set aside in an area substantially broader than that which is brought under regulations appropriate to a noncompetitive policy; and in consequence private enterprises are left free at certain points to adopt anticompetitive practices without check. For example, in the Shipping Act of 1916 common-carrier rate agreements approved by the Maritime Commission were exempted from the antitrust laws, but the commission's authority to review agreements was so limited by the statute as to be insufficient to protect certain aspects of the public interest. The commission was given specific authority to prevent rates from being unjustly discriminatory, but its power to prevent rates from being unduly high and to prevent activities designed to limit the volume of traffic or to destroy competitors rested merely upon a general right to disapprove agreements that operate to the detriment of the commerce of the United States. Since the commission did not endeavor to stretch this ambiguous power so that it included control over rate levels, the shipping lines were enabled in practice to agree with impunity about the level of their rates. It should be an object of public policy to eliminate such no man's lands along the boundaries of the competitive area.

Moreover, there is sometimes danger that power acquired by a business enterprise in a noncompetitive area may be used to obtain monopolistic advantage in a supposedly competitive area. Communications companies, for example, often hold, under public regulation,

monopolies of certain territories and types of service. In some fields of communication, a single company controls most of the facilities. If such an enterprise is permitted to engage in the unregulated activity of manufacturing communications equipment, its place as the largest buyer of this equipment will give it a monopolistic position as a manufacturer.[2] Similarly, if it is permitted to own patents in the communications field, its control of communications service will enable it to acquire most of the relevant patents, and these patents, in turn, will extend its power over the manufacture of equipment and over the use of the same technology outside the communications field.[3]

Though the wisdom of most exceptions in which regulation is substituted for the competitive policy will not be challenged, safeguards will be recommended that are designed to prevent the existence of an excepted area from producing monopolistic results outside that area. Moreover, since there is a possibility that when competitive and noncompetitive prices, profits, and investment policies exist side by side the allocation of resources to the competitive industries and activities may be inadvertently reduced or increased, attention will be given to the question how the performance of the excepted industries and activities can be kept consistent with that of the competitive part of the economy.

The competitive process which it is the purpose of a competitive policy to preserve is simpler, cruder, and less comprehensively beneficial than the perfect competition of classical economics. Historically, belief in competition as an automatic device for reconciling private greed with the public interest went hand in hand with disregard of the imperfections of the competitive process. Competition was described as if all persons engaged in it were well informed and perfectly rational; as if they could transfer their purchases and productive activities from one product or market to another without difficulty; as if they did so under the sole stimulus of comparative costs, utilities, and prices; and as if they were so small and numerous that each counted only as an anonymous unit in the interplay of forces. In so far as obstacles to this kind of competition were recognized, they were supposed not

[2] Such a dual position in controlled and uncontrolled areas may also be used to destroy the effectiveness of public control. See p. 262.

[3] An example is the use of communications patents to control motion-picture sound reproduction. See Federal Communications Commission (Special Telephone Investigation), *Report on Electrical Research Products, Incorporated,* Investigation Docket No. 1, Vol. II, Jan. 30, 1937.

to change the character of the competitive process but merely to delay its working out. The same results were to be expected "in the long run." The results of perfect competition were supposed to be the best possible allocation of economic resources, the maximum possible aggregate production, and reward of all producers according to their productivity. These were characteristics of a so-called "equilibrium," which competition tended to establish.

Competitive industries are never perfectly competitive in this sense. Many of the resources they employ cannot be shifted to other employments without substantial cost and delay. The allocation of those resources, as between industries or as to relative proportions within a single industry, is unlikely to have been made in a way that affords the best possible expenditure of economic effort. Information is incomplete, motivation confused, and decision therefore ill informed and often unwise. Variations in efficiency are not directly reflected in variations of profit.[4] Success is derived in large part from competitive selling efforts, which in the aggregate may be wasteful, and from differentiation of products, which may be undertaken partly by methods designed to impair the opportunity of the buyer to compare quality and price. Profit is sought not only in producing or distributing goods but also in a wide variety of financial manipulations that have no fixed relationship to the productive process. Rivalry is often between a few concerns that strike at one another in a conscious effort to do injury rather than between a large number of concerns that compete anonymously and impersonally. Incentives to limit production and maintain prices are often dominant in spite of this rivalry.

Such obstacles prevent competition from automatically guaranteeing that productive capacity will be fully utilized, that prices will express only necessary costs and minimum profits, that rewards will be proportional to efficiency and productivity, and that the allocation of re-

[4] Plants built in periods of high prices have high equipment costs which are translated into high fixed charges, as compared with competing plants built in periods of low prices. Plants that have been recapitalized downward in periods of financial stress have unusually low fixed charges thereafter. Subsequent managements inherit such inequalities of position as factors making for competitive advantage or disadvantage regardless of their own efficiency.

Moreover, price policies differ, so that the most efficiently produced product may not be the lowest priced; and public acceptance of competing products is not wholly logical, so that the cheapest and best products are not necessarily the easiest to sell. Because of factors such as these, commercial success may not be an accurate measure of functional efficiency.

sources will be such as to provide the largest possible aggregate production. Hence most economists have ceased to assert that competition should be the sole basis of public policy. They recognize that competition alone is not sufficient to keep production and employment at high levels or to establish productivity as the basis for income. They have begun to propose a variety of positive measures directed to these ends. To one who looks for such results from competition, the impossibility of establishing the competition that might produce them must raise the question whether competition is worth preserving at all.

But although the maintenance of competition will not guarantee that the economy will work well, impairment of competition by monopolistic restrictions, public or private, increases the chance that it will work badly. Although the imperfections of the competitive process are too great to make economic adjustments quick, neat, and exact, the forces of competition tend to reduce many substantial economic maladjustments. Bad allocations of resources are improved somewhat by migrations of labor and capital so long as entry into the more profitable fields of employment is not artificially restricted. Where output is limited and rewards are high, new producers are likely to be attracted and production consequently enhanced. Such adjustments are often slow, and, if the discrepancies are small, may not take place. Even as correctives for major conditions of imbalance, they are incomplete. For example, ignorance, custom, community sentiment, and political obstacles to migration may keep excessive amounts of labor in a low-wage area even when there are no monopolistic restrictions to prevent entry into higher paid occupations elsewhere. Nevertheless, the effect of private restrictions and of public trade barriers imposed for monopolistic purposes is to reduce still further the possibility of appropriate economic adjustments.

Moreover, the usefulness of a competitive policy does not depend exclusively or even primarily upon the ability of competition to solve such broad problems. The direct purpose of the competitive policy is to curb business agreements and accretions of monopoly power that directly limit the productivity of industry or directly make industrial bargains one-sided. No general theory of the beneficence of competition is required to support the view that if antiproductive and exploitative arrangements can be identified, they should be regarded as contrary to the public interest. The competitive policy presupposes that unchecked private power will ordinarily be used to bring about exploitation and restriction of output; but in striking at extreme de-

partures from competition it does not necessarily aim at an atomized competition such as was envisaged in the older economic theory. The grounds for the policy include not only dislike of restriction of output and of one-sided bargaining power, but also desire to prevent excessive concentration of wealth and power, desire to keep open the channels of opportunity, and concern lest monopolistic controls of business lead to political oligarchy. These aims are almost platitudinous. Historically, they antedate conceptions of the economic equilibrium and of the role of competition in achieving it. They do not require perfect competition but may be served by the imperfect competition that prevails in actual competitive markets.

This competition consists in access by buyers and sellers to a substantial number of alternatives and in their ability to reject those which are relatively unsatisfactory. Its structural characteristics in a particular market are as follows:

1. There must be an appreciable number of sources of supply and an appreciable number of potential customers for substantially the same product or service.[5] Suppliers and customers do not need to be so numerous that each trader is entirely without individual influence, but their number must be great enough that persons on the other side of the market may readily turn away from any particular trader and may find a variety of other alternatives.

2. No trader must be so powerful as to be able to coerce his rivals, nor so large that the remaining traders lack the capacity to take over at least a substantial portion of his trade.

3. Traders must be responsive to incentives of profit and loss; that is, they must not be so large, so diversified, so devoted to political rather than commercial purposes, so subsidized, or otherwise so unconcerned with results in a particular market that their policies are not affected by ordinary commercial incentives arising out of that market.

4. Matters of commercial policy must be decided by each trader separately without agreement with his rivals.

5. New traders must have opportunity to enter the market without handicap other than that which is automatically created by the fact that others are already well established there.

[5] Products and services may be differentiated. Indeed, some variety in what is offered for sale may increase the buyer's opportunity to protect himself by choosing the more satisfactory product. However, differentiation should not be so confusing, nor gaps in quality so wide, as to prevent choice on a basis of relative prices or other significant characteristics of the transaction.

6. Access by traders on one side of the market to those on the other side of the market must be unimpaired except by obstacles not deliberately introduced, such as distance or ignorance of the available alternatives.

7. There must be no substantial preferential status within the market for any important trader or group of traders on the basis of law, politics, or commercial alliances.

Where markets are so organized, competition affords a rough and limited but effective safeguard for certain interests of those immediately involved and for certain aspects of the public interest. A buyer who has several sources of supply, or a seller who has a considerable number of potential customers, is protected against unduly burdensome terms by his ability to deal elsewhere; and the knowledge that this protection is available encourages him to demand what he wants and persuades those who deal with him to make their proposals reasonable in the light of the preconceptions that prevail within their trading community. Thus the rivalry of the traders gives each an incentive to improve his performance and to offer better terms. There is no guarantee that anyone will obtain the best possible bargain, but there is no need for anyone to accept an exceptionally bad bargain. Moreover, if every trader is free to adopt innovations, there is substantial opportunity for experiment and considerable chance that improvements in products, improvements in processes of production, and reductions in price will result. The decentralized character of the authority to manage business affairs makes it probable that many experiments will be ill conceived or wastefully duplicated and that certain business enterprises will be slow to adopt the best new techniques. Hence progress is unlikely to be as rapid and economical as it might be if all production were effectively controlled by a vigorous, wise, and enthusiastic leader. However, since social organization cannot be based upon the presumption that leaders will always be vigorous, wise, and enthusiastic and that they will effectively control those they lead, the progress attained through competitive experimentation may be the most that is feasible. Whether or not this is so, the decentralized process is a guarantee that experiment will not be stopped entirely by lethargy or self-interest. This guarantee is enhanced by the fact that newcomers may enter the market. Furthermore, those who consistently offer the worst terms or use the worst techniques are likely to be weeded out, so that extremes of inefficiency, greed, and chicanery are automatically eliminated. Though such a process does not guarantee

the best imaginable results, it affords a practical safeguard against intolerable ones and is consistent with progressive improvement of those actually achieved.

Thus conceived, competition is not, of course, a complete basis for public policy. It cannot be expected to assure full production, distributive justice, protection against widespread economic distress, or stability in contrast to the swings of the business cycle. Although it affords flexibility in the use of resources, it cannot be expected to overcome the lags and frictions of folkways and of human ignorance. Its function with reference to all such problems is to prevent the defects of social organization from being made worse by deliberate adoption of restrictive policies designed to serve private interests. It minimizes planned restrictions of output, deliberate exploitation of the weak, and deliberate refusal to adopt new methods. It eliminates extremes of inefficiency. These are the limits of its usefulness. To accomplish these purposes competition is an appropriate part of any public policy. If constructive programs can be developed which improve the performance of the economic system, there is strong ground for adopting them; but there will still be need to provide safeguards against onerous bargains and to guarantee opportunities for economic progress. Although not means to an economic utopia, these safeguards, like garbage collection, are necessary, if insufficient, for the public health.

There is room alongside competition for supplementary policies of various types. Moreover, it is possible that by changes in the rules of the competitive game the safeguards of competition may be made more satisfactory or that noncompetitive processes regulated by the state may do even better, either in general or in particular cases. Such possibilities of supplementing, perfecting, or replacing competition must be considered in any comprehensive discussion of government policy toward business; but they are not directly relevant to a discussion of the way in which the roughly effective competitive safeguards can be preserved.

The competitive policy may go along with a variety of state activities and direct regulatory controls over private activities. Where competition stands alone, its function is to provide the minimum safeguards already described. Where it supplements other policies, its function is to provide these safeguards in so far as they are not otherwise provided and to make sure that the public controls are not destroyed or evaded by collusive or monopolistic private action. To maintain competition within an economic area is usually to econo-

mize the use of public control. To prevent anticompetitive private activities in a publicly controlled area is to accept only those substitutes for competition which have been publicly approved and which presumably contain substitutes for the ordinary competitive safeguards. Competition remains indispensable in a mixed economy, even though its functions are limited.

The competitive policy has been challenged in recent years, not merely from the mistaken opinion that it is identical with an exclusive reliance upon competition in economic affairs, but also from the opinion that this policy is inconsistent with specific constructive programs intended to stabilize the economy, to maintain the solvency of economic groups, and to achieve the advantages of cooperative action. Private price fixing within reasonable limits has been advocated as a device for stabilizing price levels and thus avoiding depressions. Collusive restrictions have been proposed as devices by which extremes of competitive pressure can be averted from threatened groups and these groups can be saved from bankruptcy. Much has been said about the economy and efficiency that can be achieved by joint action in conducting research, providing delivery service, and performing various other economic functions.

Such arguments against the competitive policy are, for the most part, insubstantial. Neither analysis nor experience supports the view that stable price levels can be achieved by allowing uncoordinated groups of businessmen to agree privately upon price-maintaining devices and to make these devices effective so far as they are severally able to do so. Indeed, private price fixing often overreaches itself, establishing prices so high that they bring about overexpansion of productive capacity, collapse of the price agreement, and then unusually low prices.[6]

[6] The League of Nations says of the American group, Copper Exporters, Inc.: "The announced purposes of the group were to eliminate middlemen, to prevent manipulation, and to 'stabilize prices' by price-fixing. Stabilization of prices turned out to mean higher prices. For two years the price of copper was maintained around the 15 cent mark, then it was raised until it reached the remarkable level of 24 cents a pound. Then for an entire year, beginning in April, 1927, the price, both for exports from the United States and for domestic sales, was held at 18 cents, in spite of declining sales and rapidly mounting stocks. The control finally broke down in 1930. Copper prices fell rapidly, with disastrous results to manufacturers who had made commitments on the 18 cent basis. The artificially high prices maintained by Copper Exporters, Inc., had hastened the development of new capacity in African and Chilean fields, so that the industry entered the depression in a state of hopeless overexpansion." League of Nations, Economic, Financial, and Transit Department, *Raw Material Problems and Policies,* p. 42, Geneva, 1946.

The unbalance and fluctuation of a price structure run upon this principle would probably be at least as great as that in our present economy. Whether or not price stability is desirable as an aid toward stable production and employment, uncoordinated private price fixing can contribute nothing to these purposes.

Similarly, the argument for restrictive agreements as a remedy for undue economic pressure breaks down upon analysis. In an economy based upon private enterprise, the threat of business loss and of possible bankruptcy is a necessary supplement to the incentive of possible profits. The desire to avoid losses is a part of the driving force behind business. Without it, there would be a premium upon the launching of improvident and ill-conceived enterprises. Bankruptcy is one of the significant ways by which incompetent business enterprises are eliminated and by which the excessive capitalization of overexpanded industries is reduced.[7] To diminish competitive pressures for the sake of preventing business losses and bankruptcies would be reasonable only if we were prepared to provide other devices designed to check improvident expansion, to eliminate the incompetent, and to wipe out overstated values. This would entail public control of the right to do business and perhaps of the character of the performance of business. Thus the proposal to protect business enterprises against bankruptcy is logically part of a proposal to substitute sweeping controls for competition. To leave businessmen free to use anticompetitive means of eliminating the risk of bankruptcy without subjecting them to further control would be inconsistent with policies of competition and control alike. In practice, moreover, a business group that enjoyed the right to adopt collusive programs in order to resist extreme competitive pressures would be likely to see such pressures constantly on the horizon and to eliminate not only extremes of competition but all inconvenient competition.

The argument for this type of protection of the business interest is advanced, in the case of large business enterprises, on the theory that

[7] Where fixed equipment cannot readily be converted to new uses, bankruptcies tend to eliminate capital values and to bring about change of managements, but not necessarily to reduce physical productive capacity unless losses are so extreme that even direct costs cannot be covered. The failure of bankruptcy to relieve an overexpanded industry promptly from the pressure of excess capacity is often described as a difficulty that justifies other means of adjustment. However, when fixed equipment cannot be transferred to other uses, it is questionable that this equipment should cease to be employed as a productive resource, even though pecuniary returns and capital values throughout the industry may suffer in consequence.

the collapse of a great concern injures so many people that it cannot be tolerated. To assert this is to argue, in effect, that the concern's activities are no longer private in character and therefore should no longer be determined privately. The logic of the argument implies a need for public regulation, of which prevention of bankruptcy would be only a small part.

Where enterprises are many and small, protection from bankruptcy is also often urged, on the ground that in such cases ill fortune in business is likely to be translated directly into family and personal poverty. What has been said implies no attack upon policies of minimum wages, annual wages, unemployment relief, family allowances, or other devices to maintain a minimum level of living for all persons in the community. Neither is it intended to deny that measures to support the prices of goods sold by self-employed petty producers may be convenient ways of safeguarding the individual lives of such persons. It may well be that a minimum of decent livelihood should be safeguarded in spite of adverse effects upon business incentives and the consequent need to set up appropriate public controls. The contention here is merely that any such programs call for explicit public sanction and suitable public control, after consideration of the problem of business incentives, and that where such control is not established there will be need to prevent unauthorized and unregulated ventures of this type.

To preserve competition in a mixed economy requires two programs. One is to prevent anticompetitive private forces from destroying competition or seriously impairing its effectiveness in those areas in which it is the basis of public policy. This requires activities designed to prevent the rise of large monopolistic organizations, to keep the differentials of size and power in business within such limits that certain concerns may not coercively jeopardize the independence of others, to assure that important points of business policy are determined separately rather than jointly, and to safeguard opportunities for access to the market both by established concerns and by newcomers.

The other program is to make certain that the controls over the noncompetitive areas of the economy are applied in such a way as to avoid public sabotage of competition in the supposedly competitive areas. In this latter task, three dangers must be avoided: first, that the private groups desiring to set aside competition will capture the machinery of the state and use it to set up schemes of public control that do not differ in purpose and effect from those of a private monopoly;

second, that the boundaries between competitive and noncompetitive areas will be badly defined so that competition is ineffective where it is supposed to prevail or so that no man's lands are created subject neither to competition nor to public control; third, that in the noncompetitive areas the controls established by the state will fail to provide adequate substitutes for the safeguards of competition that have been done away with.

The devices available to perform these tasks in the United States consist of a large number of laws and administrative policies. A central place is occupied by the antitrust laws, which forbid agreements in restraint of trade, monopolies, efforts to create monopoly, and unfair methods of competition. Enforcement of these laws is designed to make sure that important points of business policy are determined by each concern for itself, that enough concerns exist to provide alternatives of policy, that none of these concerns may coerce the others, and that enterprises may not individually or collectively interfere with access to the market by their rivals or by newcomers. These laws, in other words, are designed to maintain the conditions requisite for competition that are specified in the first, second, fourth, fifth, and sixth points of the list on pages 9-10. The antitrust laws contain no direct effort to limit the size or power of business enterprises except where it takes the form of monopoly, and consequently they do little to establish the third condition named in the list. Neither is there any other legislation appropriate to this purpose.

The boundaries of the competitive policy and the safeguards applied to noncompetitive areas are contained in a large number of different laws that establish exceptions to the antitrust policy and set up controls over designated portions of the economic system. As to the matters that are significant for a competitive policy, there is no uniformity in this legislation nor in the administrative policies which have been developed under it. There is wide variety in the care with which the boundaries between competition and control have been defined and with which substitutes for competitive safeguards have been devised and applied. Moreover, some laws that purport to set up controls in the public interest appear to be mere devices designed to serve the monopolistic purposes of private groups. Thus portions of our control laws tend to destroy the seventh condition listed on page 10 as requisite for effective competition within the competitive area.

Formulation of the broad outlines of a policy designed to maintain competition and make it effective requires an appraisal of the effec-

tiveness of the antitrust laws within the field to which they apply, consideration of the gaps in these laws and of the measures appropriate to fill these gaps, and review of control legislation with a view to amendments which will make it consistent with an effective competitive policy. These tasks are attempted in ensuing chapters. However, since both the antitrust laws and the control laws deal with a variety of problems, and since gaps in the law are evident in connection with several of these problems, it has been convenient to organize the discussion by problems rather than by types of legislation. Ensuing chapters are concerned successively with restrictive business agreements, the power of large business enterprises, the obstacles that interfere with entry into business and with access to markets, and the difficulties created by inept public controls in so far as they are not covered in the first three topics. In discussing each topic, the plan has been to describe the problems to which public policy must address itself and the controls appropriate to these problems, to appraise existing legal and administrative controls, and to indicate the changes needed to convert existing controls into those that are appropriate.

II. RESTRICTIVE AGREEMENTS

PRIVATE ANTICOMPETITIVE restrictions fall into two broad classes. The first class consists of agreements among independent business enterprises that diminish competition among the participants or deprive other concerns of opportunities to compete. The second class consists of activities by single business enterprises that have achieved sufficient power to adopt monopolistic policies toward those with whom they deal and to coerce, overawe, or exclude competitors or potential competitors. In economic discussion both types of restrictions are often referred to indiscriminately as monopolistic. At law the first type may be a conspiracy in restraint of trade and the latter type a monopoly. Although the two classes of restrictions have many similarities in economic effect, they must be considered separately here; for there are some significant economic differences between them, and there are many differences in the problems of public policy which arise in attacking them. This chapter will discuss the problem of restrictive agreements.

Agreements among businessmen to avoid competition or to prevent others from competing must be minimized in order to preserve one of the essential conditions of competition: the availability of significant alternatives for traders. Joint establishment of business policies is a means to eliminate desirable variety by eliminating alternatives in policy. It deprives traders on the other side of the market of the opportunity to protect themselves. In consequence, it enables the parties to the agreements to impose harsher terms. Similarly, joint attacks upon outside competitors are designed to reduce the number and variety of the available alternatives. In many such cases the protection of the traders on the other side of the market is diminished. In all such cases the opportunities open to outside competitors are reduced.

Restrictive agreements are the easiest ways to reduce competition. The incentive to restrict exists wherever joint action can improve the bargaining strength of the participants. The opportunity to restrict exists wherever traders are relatively few in number if there is any way to prevent easy entry into the market by new competitors. To make

a restrictive agreement, an enterprise need not lose its identity nor give up its independence in matters not included in the agreement. Mere adoption of common policies with reference to designated activities is sufficient.

For this very reason, however, restrictive agreements are vulnerable to attack. Uniformity of action is readily perceived. Where it is achieved by agreement, the purposes and methods of the participants must be explicitly formulated and made known to all who are expected to cooperate. Hence important restrictions necessarily leave a trail of suspicious circumstances and afford the investigator substantial evidence of their restrictive character. Moreover, a restrictive agreement can be terminated by any circumstance that induces important participants to resume their independence of action. Private restrictions frequently break down because some of the parties to them see advantage in disregarding them. Under public attack, a restrictive agreement can be ended without changing the organization of the participating enterprises and without assuming public responsibility for the types of policy which these concerns severally shall follow. The government can easily discover restrictive agreements if it knows what it is looking for; and it can usually destroy them without great difficulty.[1]

However, in determining what types of agreements are to be prohibited, there are difficult problems of policy. Not all joint action is restrictive in purpose or effect. For example, businessmen may undertake jointly activities that are too expensive or too complicated for a single enterprise. They may engage in industrial or economic research on a scale larger than one enterprise can afford. They may collect statistics which would not be available if they did not pool their information. There is nothing inherently restrictive in joint research or in joint provision of statistics; indeed it may be beneficial to the community at large. Similarly, businessmen may adopt common policies about some matters in which the interests of the community, like those of the business group, are better served by uniformity and coordination than by variety. For example, the members of an industry may agree upon the meaning that they will give to trade terms, such as *mayonnaise* and *salad dressing* as designations for different combi-

[1] Where such destruction is difficult, the reason is usually that the arrangement has gone so long unchallenged as to have become a part of business habits. See pp. 34-35.

nations of ingredients.[2] Deception and exploitation of the consumer are likely to spring from variety rather than from uniformity in such matters; and new variants in business policy may be facilitated rather than prevented by terminological agreement which makes possible a clear distinction between the new policy and the older ones. Such nonrestrictive agreements do not increase the bargaining power of the participants at the expense of their customers. Neither is the bargaining power of rival sellers reduced, except possibly through loss of some opportunities to mislead buyers.

Since agreements such as these have no bearing upon the safeguards which competition is supposed to provide, they are not brought into question by a competitive policy. They must be distinguished from restrictive agreements designed to increase bargaining power. Restrictive agreements pertain to matters in which the interests of participants differ from those of nonparticipants and are intended to serve the former at the expense of the latter. They eliminate types of variety that safeguard nonparticipants and establish standards of conduct which worsen the position of such persons.

CLASSES OF RESTRICTIVE AGREEMENTS

Restrictive agreements fall into two general classes, which for convenience may be described as exploitative and regulatory.

Exploitative agreements have the direct purpose, and if successful the direct effect, of substituting for moderately satisfactory prices and profits, which competitors might individually attain, the large rewards that come from joint action. The means employed are various. Sometimes there is direct agreement to fix prices at levels higher than would prevail under competition. Sometimes prices are raised or prevented from falling by devices to increase the present scarcity of goods or to limit future increases of the supply. Sometimes, by agreements which allocate markets among the participating concerns, each enterprise is enabled to adopt its own policies toward prices and production without fear of competitors. Sometimes avoidance of competition is assured by profit-sharing arrangements or joint sales agencies. Any of these programs may be accompanied by measures to exclude from the market concerns that are not parties to the agreement.

Regulatory restrictions are less ambitious. The participants in a

[2] See NRA Code (No. 349) of Fair Competition for the Mayonnaise Industry, approved Mar. 21, 1934, Article VIII, Standards, Secs. 1 and 2.

scheme of regulatory restriction often say and sometimes believe that they have not impaired competition.[8] They mean that the purpose of their agreement is not to obtain exceptional profits nor to eliminate all forms of independent competitive action which may reduce profits, but merely to prevent or regulate types of competition that often entail results different from those contemplated or regarded as desirable by any of the competitors. Whereas exploitative restrictions are intended to get rid of competitive action even where competition would provide a relatively stable existence for the competitor, regulatory restriction is designed to eliminate only the types of competitive action that, if continued, have cumulative effects regarded as harmful to all competitors. Its emphasis is upon preventing disastrous losses rather than upon making large profits.

For instance, in any industry in which producers sell a considerable variety of commodities or serve a considerable number of geographically separate markets, it is possible to compete for business upon any one of these commodities or in any one of these markets at prices and profits lower than would be acceptable for the producer's entire volume of business. Particular products may be used as so-called "leaders" to attract customers. Low prices may be maintained in particular markets to enlarge the volume of sales there. Meanwhile, higher prices upon other commodities or in other geographical markets may be relied upon to provide a sufficient total revenue to meet expenses and afford profits. If uniform methods of cost allocation are followed, such differences in price policy will appear as differences in profit margins. If, however, there are substantial joint costs or overhead costs in the productive process, these costs may be allocated unequally among markets, in such a way to to show relatively low costs in particular markets as an apparent justification for the low prices in these markets. Recovery of the relatively high costs allocated to markets in which prices have not been cut depends, of course, upon continuance of the relatively high prices in those markets. Thus, whether the differences in price policy are reflected in variations of profit or in variations of cost, the success of the policy depends upon the maintenance of price differentials. Low prices in some markets are profitable only if they are offset by higher prices in other markets.

Peculiar hazards accompany the adoption of such policies of differtial pricing. The products or markets that are selected as suitable for

[8] See *American Column and Lumber Company v. United States*, 257 U.S. 377 (1921).

low prices by one competitor are likely to be those in which other competitors are already well established. From the point of view of these other concerns, differential price reductions addressed to some of their most important markets invite retaliation. The easiest and most effective retaliatory policy is to make price reductions for the products and markets which the initiator of the price cutting has regarded as suitable for relatively high prices. In international trade the policy of making exceptionally low prices in foreign markets is often called "dumping," and retaliatory dumping policies may be described as "cross dumping." Such cross dumping arises readily in domestic markets as well as in international ones. It may take the form of retaliatory price cuts upon different kinds of commodities which are jointly produced or sold or of retaliatory price cuts between different geographical markets for the same commodity. Wherever it occurs, policies that were intended as price discriminations upon a limited portion of the total business in order to increase total sales are converted into price reductions that affect the whole business.

Such possibilities of cross dumping are inherent in competitive markets whenever it is feasible for several competitors to adopt different price policies for different parts of their business and whenever there is no common understanding as to the techniques that will be used in determining price policies and allocating costs. However, cross dumping can be avoided, or limited to an agreed amount, if the concerns exposed to it are in agreement to avoid variations between one market and another in their policies toward prices and profits, or if they are in agreement to regard particular markets as suitable for low prices and other markets for high prices. This type of agreement may be established by common understandings about the way in which costs will be allocated and the way in which prices will be related to costs,[4] or by adoption of formulas through which prices are brought into orderly relationship to those established for a few key products or markets.[5]

Regulatory restrictions may also be invoked to limit the impact of business distress. On the downswing of a business depression, enterprises suffer both from shrinkage of their volume of business and from

[4] See TNEC Monograph No. 21, *Competition and Monopoly in American Industry*, pp. 226-227. See also A. R. Burns, *The Decline of Competition*, pp. 47-55, McGraw-Hill Book Company, Inc., New York, 1936.

[5] See Federal Trade Commission, *Report with Respect to the Basing Point System in the Iron and Steel Industry*, November, 1934, pp. 15-17. See also TNEC Monograph No. 42, *The Basing Point Problem*, pp. 99-109.

price decline. Prices are recurrently cut by enterprises which need cash desperately or which hope that a price below the market may justify itself through increased volume. Many businessmen believe that such price reductions do not enhance the total volume of an industry's sales but may even induce buyers to postpone their purchases in the hope that prices will go still lower.[6] Those who hold this view are likely to believe that maintenance of prices can diminish the impact of depression upon the price-maintaining industry by assuring better operating margins upon the existing volume and by preventing such speculative delays in buying. Accordingly, periods of receding business often evoke agreements to make new prices public before they take effect, to refuse to sell below cost, or to adopt other practices intended to discourage price cutting.[7] Although many agreements of this type have been abortive, some have been partially successful and from time to time some have received governmental sympathy and support.[8]

The distinction between exploitative and regulatory restrictions that has been set forth above is sharper than the facts justify. Even the most crudely monopolistic arrangements obtain part of their impetus from the knowledge that competition sometimes becomes cutthroat. Even the most modest programs that are avowedly undertaken to stabilize competitive relationships are likely to be pushed to the point where they not only eliminate retaliatory price discrimination and panic price reductions but also diminish the incentives to keep prices generally low. Nevertheless, restrictive agreements display such difference of emphasis as to justify a rough division of types.

This classification is also justified by substantial differences in public attitudes about these two types of restriction. Few voices can be found to defend the exploitative type of restrictive agreement. Arrangements that are intended to enhance profits and prices, to diminish production or productive capacity, or to allocate markets are regarded as clearly objectionable wherever it is assumed that without such agreements a healthy competition would prevail. Agreements that can be described as means toward stability, devices to prevent cutthroat competition, or

[6] See E. G. Nourse, *Price Making in a Democracy*, pp. 292-293, Brookings Institution, Washington, D.C., 1944. See also House Document No. 158, 75th Congress, 1st Session, *A Report on the National Recovery Administration*, Mar. 2, 1937, p. 137.

[7] See H. F. Taggart, *Minimum Prices under the NRA*, Michigan Business Studies, Vol. VII, No. 3, University of Michigan Press, Ann Arbor, 1936.

[8] See L. S. Lyon and others, *The National Recovery Administration, An Analysis and an Appraisal*, pp. 580-583, 585-599, 610-611, Brookings Institution, Washington, D.C., 1935.

devices to cushion the impact of surplus capacity or of general depression are highly controversial. In public discussion they may be defended as well as attacked. Government policy has sometimes fostered them generally, as in the case of NRA,[9] and has given them enduring support in particular industries. Sometimes, as in the case of bituminous coal, they are defended on the theory that restrictions may be appropriate means to prevent an industry's income from being so reduced as to create general distress among its business enterprises and among the workingmen dependent upon it for a livelihood.[10] Sometimes, as in the case of various agricultural products, they are defended on the theory that stability in prices as between commodities and as between periods of time is preferable to the fluctuations attendant upon competition.[11] In the heavy-metal industries they are defended on the theory that they are preferable to secret price concessions and retaliatory discriminations.[12] Among economists they have defenders, not merely because price discrimination and extremes of price cutting may be disastrous to those immediately involved, but also because when competition takes this form the success or failure of enterprises may no longer depend upon their relative efficiency.

The arguments that are made in favor of private regulatory restrictions are not persuasive. To varying degrees they must be set against conflicting considerations. However desirable it may be to diminish the suffering of occupational groups, such groups must be exposed to economic pressure so long as we rely upon private enterprise rather than upon public regulation to shift resources from one industry to another. Moreover, even if economic pressures are to be diminished

[9] See Saul Nelson, *Minimum Price Regulation under Codes of Fair Competition*, NRA Division of Review, Work Materials, No. 56, March, 1936. See also L. S. Lyon and others, *op. cit.*, pp. 623-650, and TNEC Monograph No. 21, *op. cit.*, pp. 261-265.

[10] See, for example, statement of Charles F. Hosford, Jr., chairman of the National Bituminous Coal Commission, appointed under the Bituminous Coal Conservation Act of 1935, *Hearings* on S. 4668 before the Senate Interstate Commerce Committee, 74th Congress, 2d Session, June 3, 1936, p. 30. See also TNEC Monograph No. 32, *Economic Standards of Government Price Control*, p. 271.

[11] See speech by R. M. Evans, administrator of the AAA, on "The Philosophy and Objectives of the AAA Farm Program," at the Institute of Rural Affairs, Virginia Polytechnic Institute, Blacksburg, Virginia, July 20, 1939. See also address of H. R. Tolley, administrator of Agricultural Adjustment Agency, on "Components of the Triple-A Program," before Farmers' Conference, Sacramento, Calif., Feb. 22, 1938.

[12] See *The New York Times*, "To Use Steel Code Even If NRA Ends," Nov. 18, 1934, pp. 9 and 11.

on humanitarian grounds, the means adopted should not be restrictions that make goods scarcer for the rest of the community. Though particular forms of price discrimination may be highly objectionable, public policy has long recognized that discrimination may have a useful place in developing new markets, adjusting economic burdens to ability to pay, and enhancing the total consumption of products whose supply can be enlarged without substantial increase of cost.[13] There is no reason to suppose that private agreements designed to prevent cross dumping will eliminate the undesirable forms of discrimination or preserve the desirable ones. Though stability may be desirable, stable production and employment are preferable to stable prices, and the two types of stability are not necessarily consistent with each other.[14] Though price cutting in depression may be ineffective in maintaining the volume of business activity of those immediately concerned, it may alleviate a depression in another industry by leaving consumers more money to spend there and may possibly diminish rather than increase the unbalance of price structures which appears when some prices fall and others do not.[15]

If public policy toward private restrictive agreements were to be based exclusively upon the substantive merits of various types of restriction, the status of regulatory restrictions could not be determined without pushing to a conclusion the arguments that have been advanced above. If we were considering public regulatory programs designed to cope with such problems, a full exploration of the substantive issues would be essential. This would require decisions about the proper limits to the severity of competition, the merits of various types of price discrimination, and the effects of different types of price policy at different stages of the business cycle. In considering private restrictions, however, the matter may be dealt with more simply. Whatever

[13] A typical example in the professional world is the medical practice of billing in line with the patient's income and ability to pay. For a brief discussion of promotional pricing in the public-utilities industries, see Irston R. Barnes, *The Economics of Public Utility Regulation*, pp. 350-351, F. S. Crofts & Co., New York, 1942.

[14] The President's Committee of Industrial Analysis in its report on the *Operation of the National Recovery Administration* (pp. 163-164) concluded: "In general those industries which were most successful in maintaining prices were least successful in maintaining a satisfactory level of production and employment." See also *NRA Trade Practice Summarized: Effect on the Level of Prices and Production*, NRA Staff Studies, Trade Practices, Chap. VII.

[15] See testimony of Melvin G. deChazeau before the Temporary National Economic Committee, *Hearings*, Part 26, "Iron and Steel Industry," pp. 13640-13641.

its avowed purpose, a private regulatory restriction may easily be extended beyond its appropriate limits and may thus become an exploitative restriction. Private controls over prices sufficient to prevent price discriminations and retaliatory price cutting can also be used to raise price levels and afford monopoly profits. Private controls adequate to rescue a producing group in time of distress are adequate to impose distress upon customers at other times. Exploitative restrictions may take exactly the same forms of controls over cost accounting, cost-price relationships, and pricing formulas as are appropriate to regulatory restrictions. Thus it is impossible to leave private groups free to regulate without leaving them also free to exploit. If regulatory restrictions are desired, they can be had safely only through public agencies or through private activities carried on under explicit public sanction and surveillance. In fields not subjected to public regulation, restrictions by private groups should be forbidden regardless of their type.[16]

Adoption of this principle eliminates the need to classify private restrictions according to their scope and purpose. Nevertheless, it does not remove all difficulties in determining the kinds of private joint action that are to be forbidden. Private agreements often combine restrictive and nonrestrictive activities in such a way that the two are difficult to disentangle. Moreover, since unreasonably restrictive group activities are forbidden in the United States, they are seldom candidly avowed, but instead are likely to be hidden behind a mask of activities that are harmless or even desirable.

Five patterns which are relatively common will provide sufficient illustrations:

1. The first is a price-fixing or output-restricting program, which is associated with a statistical undertaking. Figures about production,

[16] Successful use of private groups as instruments to allocate scarce commodities during the war and after provides an apparent, but not an actual, exception to this principle. There is much less danger in letting businessmen agree about how to cope with a scarcity than in letting them act together with reference to a surplus. When a group makes allocations of scarce supplies among its own members, the persons immediately affected by the allocations are all represented and their self-interest is likely to prevent any serious abuse. When a group allocates its scarce product among its customers, there is considerable incentive to follow reasonable principles of allocation. Nevertheless, experience has shown that there is danger that a closely associated clique of like-minded businessmen may discriminate against independent competitors whom they regard as mavericks and against customers whom they regard as inconvenient price cutters. Public regulatory supervision to prevent such abuses is necessary, even in the apportionment of scarce goods.

stocks, sales, and prices may be collected, summarized, and distributed to members of the industry. These summaries may serve various useful purposes. But the recipients may be expected to raise prices that are below the reported average,[17] to reduce output whenever stocks exceed a stated ratio to sales,[18] to limit their own production to a fixed percentage of the industry's production,[19] or in some similar way to treat the statistics as signals for concerted action. In such cases the fact that the means of giving effect to the agreement are statistical is relatively unimportant. The significant point is that the program is designed to establish a common policy in production or marketing.

2. A more ambitious program of a similar kind is price filing. Members of an industry may agree to file copies of their prices with a central agent in order that detailed price information may reach their competitors. When the prices are not made available to customers and others, the announced purpose of such a plan is usually to enable each seller to determine the accuracy of reports he receives from his customers about the prices being charged by his competitors.[20] When the prices are supplied to all interested persons, the purpose is usually said to be to inform customers about price quotations and thus to enable those who pay the higher prices to discourage the practice of discriminating in price by demanding the lower prices.[21] Plans which merely serve these purposes are not necessarily objectionable; but programs of price filing are also usually designed to maintain a relatively high and stable price level within the industry. In the crudest of them, price reductions must not be made until a waiting period has elapsed after filing; and during this period various methods of persuasion and intimidation are used to induce the filer of the lower price to change

[17] See *United States v. Southern Pine Association et al.*, complaint, Feb. 21, 1940, Eastern District of Louisiana. Also consent decree of the same date reported in Commerce Clearing House *Trade Regulation Service*, 8th ed., Vol. 3, par. 25,394. (Hereinafter Commerce Clearing House *Trade Regulation Service* is referred to as CCH *Trade Regulation Service*.) On June 1, 1943, pursuant to certification of the chairman of the War Production Board, the decree was modified.

[18] See *American Column and Lumber Company et al. v. United States*, 257 U.S. 377 (1921).

[19] See *United States v. Stevenson, Jordan and Harrison, Inc.*, complaint, Aug. 22, 1940, Southern District of New York, par. 8-11. A consent decree was entered on the same day enjoining the alleged activities (reported in CCH *Trade Regulation Service*, 8th ed., Vol. 3, par. 25,525).

[20] See L. S. Lyon and V. Abramson, *The Economics of Open Price Systems*, pp. 135-137, Brookings Institution, Washington, D.C., 1936.

[21] *Ibid.*, pp. 111-112.

his mind. Moreover, the delay and the probability that competitors will adopt the same price before it takes effect reduce the apparent advantage of lowering the price because they lessen the amount of new business which is likely to be obtained thereby.[22] Even without the waiting period, the fact that the initiator of each price change can be identified often prevents changes that are likely to be unpopular with competitors.[23]

Similarly, in competition for business that is awarded by competitive bid, programs of bid filing usually have a strong restrictive effect. If the bidders are given access to one another's bids before the award is made, low bids are usually eliminated and either bids become identical or the successful bidder is arbitrarily selected.[24] If bids are circulated to bidders only after the award, the filing system is used to compare the successful bidder's original bid with the price at which he finally receives the contract, in order to determine whether he has made any subsequent concession, and if so to expose him to discipline.[25] In par-

[22] See Enid Baird, *Price Filing under NRA Codes*, NRA Division of Review, Work Materials, No. 76, March, 1936; and Charles A. Pearce, *NRA Trade Practice Programs*, pp. 3-39, 65-86, Columbia University Press, New York, 1939.

[23] Advocates of price filing sometimes assert that its effect is to make a market more like an organized commodity exchange and therefore more competitive. This analogy is misleading. Organized exchanges have no waiting periods; are available on the same terms to both buyers and sellers; supply information to both alike; identify publicly only the brokers who complete a transaction, and not the buyers and sellers. Thus they lack the most conspicuous anticompetitive features of price-filing arrangements.

[24] See, for example, *United States v. Associated Plumbing and Heating Merchants et al.*, indictment, Apr. 27, 1940, Western District of Washington. Twenty-one of the defendants were found guilty on Oct. 21, 1943. See also *United States v. Plumbing and Heating Industries Administrative Association, Inc. et al.*, consent decree, Dec. 22, 1939, District of Columbia, reported in CCH *Trade Regulation Service*, 8th ed., Vol. 3, par. 25,363; *United States v. Sheet Metal Association, Inc. et al.*, indictment, Dec. 12, 1939, pleas of *nolo contendere*, fines, and consent decree, Feb. 5, 1940, Eastern District of Louisiana, New Orleans Division; *United States v. Harbor District Chapter, National Electrical Contractors Association et al.*, indictment, Feb. 16, 1940, pleas of *nolo contendere*, fines, and consent decree, Aug. 4, 1941, Southern District of California, Central Division.

[25] In a practice known as "bid peddling" the awarding authority approaches certain bidders privately with suggestions that they are unlikely to receive the award unless their bids are reduced. By such higgling he sometimes obtains substantial reductions. Where bidders have cooperated to inflate their bids, this higgling process is the awarding authority's only protection. Hence collusive bidding is usually accompanied by bid filing intended to forestall such higgling. Where the original bidding was competitive, bid peddling serves no other purpose than to enhance the

ticular localities and trades, the use of a bid-filing system has apparently raised the level of bids very substantially.[26]

3. Another device for indirectly controlling prices is promotion of uniform methods of accounting. In many industries, particularly where concerns are numerous and small, business records are badly kept and accounting methods are ill understood. Encouragement of record keeping and analysis of accounts may in itself affect prices by helping some members of such an industry to avoid serious mistakes of judgment. Where joint action to promote accounting goes no further than this, its effect is sporadic, its tendency is not exploitative of the consumer, and public policy need not frown upon it.[27] Indeed, better informed business is likely to be more efficient business. In many cases, however, what is called accounting is actually a device for procuring common action of the regulatory type described earlier in this chapter. Members of the industry are encouraged to use a uniform formula that reflects a uniform policy about such matters as the relative amounts of overhead cost which should be incorporated in the prices of jointly produced commodities. Moreover, the formula may become a device for exploitative increase of prices. Often it makes some element of cost appear to be identical for all competitors, although actually lower for some than for others, or encourages each competitor to exaggerate the apparent cost of his activities. Costs may be inflated by including in them elements of profit. In some cases the result is to make all prices uniform, in others merely to set a minimum below which prices are not supposed to go or to make the lowest prices higher than they would otherwise be.[28] Such programs are designed

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psychological pressure upon the bidder; and it is generally resented by bidders as an unfair practice. See Federal Trade Commission, *Report on Open-price Trade Associations,* 70th Congress, 2d Session, Senate Document No. 226, Feb. 13, 1929, pp. 273-275.

[26] The manager of one bid-filing system assured the writer that although the contractors in his group had no access to bids until after the award was made, the use of the system had raised the average level of bids at least 30 per cent.

[27] Indeed, the Federal Trade Commission has taken the lead in promoting such practices. See Federal Trade Commission report, *Fundamentals of a Cost System for Manufacturers,* Government Printing Office, Washington, D.C., July 1, 1916.

[28] See *United States v. W. C. Bell Services, Inc. et al.,* complaint filed Oct. 27, 1941, District of Colorado, par. 12-13. A consent decree was entered the same day enjoining the defendants from engaging in the alleged activities, including fixing and maintaining uniform markups in the sale of lumber, and compiling and disseminating statistical information as to cost, margins, etc., if such information purported

to control prices rather than merely to improve the information used in making independent business decisions.

4. Standardization programs are sometimes used to exclude competitors from an industry. In many industries there are programs to give uniform meaning to trade terms, to establish measurements of quality, to certify the quality of merchandise after inspection, or to eliminate meaningless variation in the characteristics of goods. Such programs often protect buyers against their own ignorance, help them to make more intelligent choices, and thus protect producers against loss of business to competitors who use practices bordering upon fraud. But standardization can serve other purposes also. Where a trade association establishes grading standards and provides the inspection service through which the grades are made effective, discriminatory grading may be used to harass independent competitors, or public officials may be induced to exclude such competitors by specifying that products must bear the association's trade-mark.[29] False or misleading grades and standards may be adopted in order to overcharge the consumer for inferior products or to discriminate in price upon products that actually have the same quality.[30] Such perversions often contribute little to, or even detract from, the effectiveness of standardization in enabling the consumer to buy more intelligently and in protecting the producer against unfair practices. But they contribute substantially to such purposes as raising prices and reducing the number of competitors.

5. Programs for private adjudication of disputes and private assessment of penalties may enhance the effectiveness of any restrictive un-

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to represent average or typical elements of cost throughout the market or between competing dealers, or if the information could be readily used as a basis for the establishment of uniform prices, price movements, or uniform formulas for pricing between competitors (par. III, IV). Reported in CCH *Trade Regulation Service,* 9th ed., Supp. 1941-1943, par. 52,701.

[29] See *United States v. National Lumber Manufacturers Association,* complaint filed May 6, 1941, District of Columbia, par. XVI-XIX. See also consent decree entered the same day, par. III h-m, reported in CCH *Trade Regulation Service,* 9th ed., Supp. 1941-1943, par. 52,593.

[30] Under NRA manufacturers of wood-cased lead pencils attempted to obtain approval for rules by which different so-called "grades" of lead pencils would be identified by different colors. However, there appeared to be no basis for the grading except the price at which the pencils were to be sold. See NRA Division of Review, Work Materials, No. 38, *Information Concerning Commodities,* by Hunter P. Mulford (February, 1936), Part B, pp. 76-77.

dertaking by making it enforceable even if the courts should treat it as inconsistent with public policy. International cartel arrangements, for example, are sometimes supported by agreements that the members of the cartel will arbitrate their differences in Switzerland, where the substance of the dispute may be kept secret and yet the award may be enforced in the courts of the republic.[31] In the United States restrictive programs sometimes provide that the participants will deposit stipulated sums where a controlling agency may draw upon them as liquidated damages in case the agreement is violated.[32] Private adjustment of disputes is, of course, a useful short cut in commercial intercourse; but private procedures to enforce contracts and to impose discipline may be used to nullify public policy.

In the foregoing cases the principle of public policy is clear, but its application may be difficult. There is nothing inherently injurious to competition in exchange of information among business enterprises; in promotion of better record keeping and better methods of analyzing costs; in improvement of public information by grading, testing, and standardizing commodities; or in private settlement of disputes. So long as such programs are merely what they seem to be, they should be permitted and even encouraged. When they become devices for restrictive ends, their apparently innocent character should not protect them. The difficulty of applying public policy is proportional to the ingenuity of business groups in concealing restrictive purposes under innocent cloaks and in imposing restrictive features upon programs that have already been undertaken for innocent purposes.

Where monopolistic and innocent purposes have been combined, the purpose of competitive policy should be to eliminate the restrictive features of the agreement without destroying it in other respects. The greater the ingenuity of the business group in commingling restrictive and nonrestrictive elements, the more difficult is the surgical operation by which restriction is removed. In the extreme case a choice may be necessary between destruction of the program as a whole and continuance of the restrictive arrangement. In such instances restrictions that are merely ancillary and incidental to nonrestrictive programs need not be disturbed, but restrictions that are substantial and deliberate

[31] See H. Kronstein, "Business Arbitration—Instrument of Private Government," *Yale Law Journal*, Vol. 54, No. 1 (December, 1944), pp. 44-52.

[32] See *Paramount Famous Lasky Corp. v. United States*, 282 U.S. 30 (1930). For a brief statement of liquidated damages under NRA Codes, see TNEC Monograph No. 21, *op. cit.*, pp. 265-266.

should not be spared.[33] The working rule should be to get rid of the latter type of restriction whatever the cost. This rule is appropriate, not because the benefits of such schemes are always less than the evils, but on the practical administrative ground that, since the extent to which collusive elements are entangled in constructive programs is capable of control, the people who formulate such programs must be given an incentive to avoid inextricable entanglements.

DIFFICULTIES IN PREVENTING RESTRICTIVE AGREEMENTS

Since collusive programs are concealed as far as possible, their character must often be inferred, without direct evidence of purpose, from the behavior of those who participate in them. Quoted prices and terms of sale may be identical for all competitors and may remain unchanged for long periods of time. Bids submitted to government agencies may show no variation. Analysis of price structures may suggest that they are derived from a formula which has been used in identical fashion by all competitors.[34] In such cases the question is sometimes asked whether a competitive policy requires insistence upon variation in prices and price formulas.

[33] This is the principle of the common law, carried over into the Sherman Act. See *United States v. Addyston Pipe and Steel Company*, 85 Fed. 271 (1898).

[34] For example, basing point methods of price quotation reduce geographical price variations to formulas under which the delivered price for any locality can be computed from a base price and a published freight rate. In practice the base prices quoted by different enterprises are almost always identical and the delivered prices throughout the country become identical too. It is theoretically conceivable that such a structure could arise under competition; but the technical difficulties of basing point pricing are so great as to require many decisions interpreting the meaning of the basing point formula in doubtful cases. (For example, shall delivered prices be based upon water or rail freight charges where both systems of transportation are available?) Moreover, variations in sources of goods and of orders alter the marketing problems of individual producers and would be likely to lead, in competitive markets, to frequent alterations of the basing point formula. (For example, American potash, produced in the Far West, was quoted f.o.b. Atlantic and Gulf ports because European potash, which at first was the preponderant part of the supply, was so quoted; but when the Second World War cut off European supplies, American producers continued to quote in the same way until their practice was altered by an antitrust proceeding. See *United States v. American Potash and Chemical Corp.* (1940), reported in CCH *Trade Regulation Service*, 8th ed., Vol. 3, par. 25,461.) When interpretative decisions by all producers are identical and when basing point formulas remain relatively unchanged in spite of changing conditions, the evidence of collusion becomes very strong.

But the problem is not one of principle but of evidence. Collusion may be proved either by direct evidence of agreement or by inference from the results of the agreement, and in using either type of evidence cases will be encountered in which the available facts are not conclusive. Fortuitous identities in market behavior should not be attacked on the theory that identity as such cannot be tolerated, but evidence drawn from identities should be used freely in attacking the collusion against which public policy is directed. What is to be preserved is not difference of price at a particular moment, but a continuing situation in which traders determine their policies separately and thus can be induced to give full recognition to circumstances which favor the buyer. If that situation prevails, prices that are momentarily identical may readily diverge.

A more difficult problem is that of tacit collusion. Where concerns are relatively few in number and their executives have been in close personal contact with one another for a long time, a common program of action may be developed without formal written agreement. The golf course, the lunch table, or the clubroom may become a breeding ground of collusive understandings.[35] In such cases the existence of collusion is hard to prove and its basis is hard to destroy.

Nevertheless, the task is not hopeless. The productive activities and marketing methods of a modern enterprise become more complicated as the concern's size increases. Where enterprises are large enough and few enough to make tacit collusion possible upon a significant scale, the subject matter of collusion is likely to be very complicated indeed. Prices translate themselves into lists of the prices of many commodities in many markets, subject to a variety of discounts and terms of sale applicable to many types of transactions. Output policies involve the productive activities of various plants producing a substantial number of different products, not merely for immediate sale but for warehouse stocks and for inventories of goods in process. Only simple understandings can be tacit, but simple understandings cannot be applied to such a range of phenomena unless means have been developed to create uniformity in most of the possible variables. The necessary basis for tacit collusion is explicit and detailed agreement upon terms of sale, marketing methods, the character of price struc-

[35] For a brief discussion of the so-called "Gary dinners" as a device for price regulation in the steel industry, see Eliot Jones, *The Trust Problem in the United States*, pp. 225-230, The Macmillan Company, New York, 1927.

tures, and similar matters. It is alleged, for example, that price agreements are often made in the steel industry by tacit understandings as to changes in base prices. Whether or not this is true, it would be impossible unless the steel companies could rely upon identical policies in quoting prices from designated basing points and in deriving the prices of particular products from base prices by uniform application of elaborate lists of extras and deductions designed to take account of variations in size, quality, and other characteristics of each product. Price policies so elaborate cannot be kept parallel without formal collusion.[36] The most direct means of attack upon tacit collusion is to break up such supplementary collusive uniformities.

Two difficulties loom large in such an assault upon tacit collusion. The first is the fact that a portion of the uniformity of trade practices is likely to be desirable in the public interest. Standard terms of delivery and payment, standard methods of describing commodities, uniformity in the sizes of parts produced by different makers, a standard principle for variations of price within a line of products—identical policies as to matters like these are often a convenience to buyers and sellers alike.[37] In the absence of such identities the bargaining necessary to complete a transaction may be prolonged, the buyer's ability to do business with more than one seller at the same time may be circumscribed, and discrimination among customers may be intolerably great. Where regulated markets have replaced competitive ones, the regulatory authority often has insisted, on behalf of the public, that certain uniformities in terms of sale be maintained.[38] As long as competitors continue to vie with one another in the important elements of quality, price, and service, the standardization of the lesser elements deprives the consumer of no significant protection; indeed, by making transactions more nearly comparable, it is likely to increase the intensity of competition.

To distinguish between the uniformities which strengthen the com-

[36] See Federal Trade Commission Report on Steel Industry, *Practices of the Steel Industry under the Code,* Mar. 11, 1934, in response to Senate Resolution 166, of Feb. 2, 1934, pp. 5-9. See also Federal Trade Commission *Report to the President with Respect to the Basing Point System in the Iron and Steel Industry,* Nov. 30, 1934, pp. 4-9 and Appendix A, pp. 45-59.

[37] Standard terms of sale are widely used, for example, in auction markets for produce. See M. T. Copeland, *Problems in Marketing,* 3d rev. ed., p. 235, McGraw-Hill Book Company, Inc., New York, 1927.

[38] See, for example, *Report of the Federal Trade Commission on Agricultural Income Inquiry,* Part I, pp. 41-45.

petitive process and those which become the basis for tacit collusion is a delicate matter. Short of entrusting to a public authority the right to establish such uniformities or to approve their establishment, there are only two methods of attack. The first is to proceed case by case, requiring abandonment of the uniformities that are found to make tacit collusion effective in each particular instance. The second is to classify uniformities loosely into two groups, of which one is regarded as more serviceable than dangerous and the other more dangerous than serviceable. However, the second method would be difficult to use because there is wide variation in the significance of terms of sale in different industries. In most industries, for example, cash discounts are small and relatively uniform; but in certain industries in which there are unusual risks of loss, cash discounts are large, and variation in the rate of cash discount is a significant form of price variation.[39] Moreover, in a given industry any one of the terms of sale may differ in importance to different traders. For example, large buyers of industrial equipment may be able to service what they buy, whereas small buyers may rely upon the seller for servicing; and under such circumstances agreement among sellers to limit the service provided with a sale is likely to seem reasonable to the former but unduly restrictive to the latter. To cope with such problems in advance by general rule is not feasible. Case-by-case procedure is inevitable.

The second difficulty with respect to tacit collusion is due to the momentum which can be obtained by a program of collusive joint action. As we have seen, collusion is seldom possible without explicit agreement. Once a pattern of collusion has been worked out, however, no action by the government to destroy the formal agreements in which it is expressed can expunge knowledge of the pattern from the minds of those who have accepted it. To continue is always easier than to commence. If, for example, the members of an industry have agreed to use certain basing points and certain discounts, or to compute their prices or regulate their output in accord with a prescribed formula, the executives of individual establishments may continue to follow such policies, even though they act separately rather than jointly. Thus collusion which was not originally tacit may become tacit, and uniform trade practices which are necessary to tacit collu-

[39] During NRA the writer encountered in one of the garment trades a practice in which cash discounts ran as high as 8 per cent, and enlargement of the rate of cash discount was a common form of price concession.

sion may tend to persist in tacit form. To destroy the momentum of such a system, one must either require the participants to make specified alterations in their business policies sufficient to destroy the possibility of following the previous pattern, or else deprive them of the information which they need in order to make individual decisions in accord with the collusive understanding. Enterprises may be required, for example, not merely to abandon agreements about discounts and basing points, but also to adopt new systems of price quotation.[40] Concerns that use a price or production formula based upon statistics of sales or shipments may be required not merely to abandon their agreement to use the formula but also to cease collecting the statistics.[41] Thus extirpation of the techniques of tacit collusion may require intervention in the business decisions of individual enterprises and insistence that groups of enterprises abandon activities that may be, in themselves, innocent or even useful. Competition is more readily preserved, and the discretion of business executives is less impaired in the process of preserving it, if collusive arrangements are prevented or struck down as soon as they arise rather than tardily destroyed after they have become well established.

Tacit collusion can be attacked through the structure of business enterprise as well as through business behavior. Tacit agreement is possible only where the power to control an industry has come to rest in relatively few hands. Agreement among a large number of people cannot be tacit. In the larger industries concerns cannot be few unless they are also large. In so far as the problem of size can be solved, much of the problem of tacit collusion will also be solved. This matter is discussed further in a subsequent chapter on concentration of economic power.

Closely associated with tacit collusion is the phenomenon that has come to be known as "price leadership." Where price leadership prevails, a powerful concern takes the lead in announcing policies which

40 See *United States v. American Potash and Chemical Corp. et al.*, consent decree entered May 21, 1940, Southern District of New York. Among other requirements, the decree prohibits the defendants from agreeing to fix and maintain potash prices or sales terms and from agreeing to quote prices only on the basis of c.i.f. certain ports. The defendants are required to allow customers to buy on a delivered basis or f.o.b. point of production as they choose. (Reported in CCH *Trade Regulation Service*, 8th ed., Vol. 3, par. 25,461.)

41 See *United States v. West Coast Lumbermen's Association et al.*, consent decree entered Apr. 16, 1941, Southern District of California, Central Division, par. III m. Reported in CCH *Trade Regulation Service*, 9th ed., Supp. 1941-1943, par. 52,588.

are followed by a substantial number of lesser concerns. Price leadership differs from tacit collusion in two respects: first, that the number of enterprises may be greater and, second, that there may be no interchange of opinion, even on an informal basis, prior to announcement of the leader's policy. There is reason to believe that price leadership appears to be more prevalent than it actually is. Indeed, in certain cases collusive agreements masquerade as price leadership;[42] that is, one participant in an agreement announces a course of action consistent with it and the other participants subsequently act in the same way. Nevertheless, cases of true price leadership probably occur with moderate frequency.

Like tacit collusion, price leadership depends upon the existence of enterprises with exceptional power. It occurs most readily where there is a substantial discrepancy in size between the leader and the followers. Under these circumstances the leader has at his disposal various coercive devices with which he can intimidate the smaller members of the industry.[43] Moreover, his own restrictive policies are likely to establish prices and profits that are welcomed by members of the industry who would not have the power to set similar levels for themselves. A combination of fear and desire to take shelter under a monopolistic umbrella produces followers who surrender their own freedom of action. Thus two lines of attack are open. The first would seek to nullify the effect of coercive tactics and thereby to minimize the fear which can be created among small members of an industry by a larger competitor. The second would attempt to minimize the disparities of size from which the large competitor obtains both his power to coerce and his power to raise prices by restrictive tactics. Policies appropriate to these ends are discussed in subsequent chapters.

[42] In one case which the writer encountered while in government service, an executive of a manufacturing company wrote to a colleague that a meeting of competitors had been held to determine the price that was to prevail in the next marketing period, that the decision had been by majority vote, and that the new price would be announced by one of the companies upon a stated day.

[43] For an interesting discussion of pressure of this type, see testimony of H. L. Randall, president, Riverside Metal Company, TNEC *Hearings*, Part 5, "Development of the Beryllium Industry," pp. 2084-2090. In Exhibit No. 485, p. 2285 of the *Hearings*, the Riverside Metal Company said that its price policy was to follow the prices published by a larger unit of the industry (The American Brass Company). The company said it had no alternative, whether the leader raised or lowered prices.

THE CONTENT OF THE LAW AGAINST COLLUSION

Two means are available to identify the private restrictions which are to be forbidden. One is to devise an explicit list of the subjects upon which businessmen may not agree. The other is to prohibit restrictions in broad language and to establish a procedure through which the application of the language to particular agreements is determined as cases arise.

The latter procedure has been adopted in the American antitrust laws. The Sherman Act broadly prohibits contracts, combinations, or conspiracies in restraint of trade.[44] In 1914 this statute was supplemented by the Clayton Act[45] and the Federal Trade Commission Act.[46] Though planned as a specific definition of forbidden practices, the former statute forbade only price discrimination, tying contracts and exclusive dealing arrangements, intercorporate stock acquisitions, and interlocking directorates; and except in the case of interlocking directorates even these prohibitions were applicable only where the effect might be a substantial lessening of competition or a tendency toward monopoly.[47] The Federal Trade Commission Act broadly prohibited "unfair methods of competition in commerce." Thus the application

[44] Act of July 2, 1890, 26 Stat. 209, 51st Congress, 1st Session (15 U.S.C.A., Sec. 1).

[45] Act of Oct. 15, 1914, 38 Stat. 730, 63d Congress, 2d Session (15 U.S.C.A., Sec. 12).

[46] Act of Sep. 26, 1914, 38 Stat. 717, 63d Congress, 2d Session (15 U.S.C.A., Sec. 41).

[47] The prohibitions of the Clayton Act applied to behavior by individuals and corporations rather than to agreements as such. However, the rule against price discrimination obviously served to forbid agreements aimed at this result; that which forbade a seller to enter into tying contracts and exclusive-dealing contracts obviously was designed to prevent such agreements from arising; that which forbade corporations to acquire stock from others obviously served as an obstacle to agreements for stock transfer; and that which forbade directors to sit on the boards of competing corporations served to prevent those enterprises from agreeing to combine by such means. Price discrimination and tying and exclusive-dealing contracts were forbidden only where the effect "may be to substantially lessen competition or tend to create a monopoly in any line of commerce." Stock acquisition was forbidden where there were similar effects and also where the effect might be to substantially lessen competition between the acquiring and the acquired corporation or between two acquired corporations. Only in the case of interlocking directorates did the act include a prohibition that did not depend upon the test of effect. In subsequent amendment of the law of price discrimination, the test of effect was retained with reference to discriminations in general (Sec. 2A) but was discarded with reference to payment of brokerage (Sec. 2C), grant of sales services (Sec. 2E), and payment for services rendered by the buyer (Sec. 2D).

of the antitrust laws to restrictive agreements was made to depend upon the interpretation of such phrases as restraint of trade, substantial lessening of competition, and unfair methods of competition.

Determination of the scope of these phrases was left for decision by the courts and the Federal Trade Commission (FTC) in proceedings under the statutes. Under the Clayton Act and the Federal Trade Commission Act the FTC was free not only to institute proceedings but also to decide cases. However, its views could be enforced only through appeal to the courts. Under the Sherman Act, cases were initiated in and decided by the courts. The terms *restraint of trade* and *unfair methods of competition* already had meaning at common law.[48] Building upon this foundation, the courts have gradually evolved a body of judicial precedents through which the scope of the prohibitions has become relatively clear.

In applying the Sherman Act the courts have made use of a so-called "rule of reason"; and the attitudes developed in giving effect to this rule have also influenced the interpretation of other portions of the antitrust laws. The rule of reason has been variously described as a distinction between central and ancillary restraints of trade,[49] a distinction between restraints that are significant and those that are unimportant,[50] and the mere application of logical processes to the interpretation of the statute.[51] However it may be explained, its effect has been to authorize activities and agreements which, strictly interpreted, appear to limit freedom of action but which nevertheless are thought to have no significant objectionable consequences. Roughly speaking, the distinction between the lawful and the unlawful under the rule of reason depends upon actual or probable effect. Thus the rule becomes a device by which evidence and analysis as to the economic significance of a course of action become influential in shaping the interpretation of the statute.

In applying the rule of reason to restrictive agreements, the courts have condemned price fixing with unusual clarity. They have an-

[48] See Milton Handler, "Unfair Competition," *Iowa Law Review*, Vol. 12, No. 2 (January, 1936), pp. 175-262. See also Joseph E. Davies, *Trust Laws and Unfair Competition*, Bureau of Corporations, Department of Commerce, 1915, Chaps. 2 and 7.

[49] *United States v. Addyston Pipe and Steel Company*, 85 Fed. 271 (1898).

[50] *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933).

[51] *Standard Oil Company of New Jersey v. United States*, 221 U.S. 1 (1911).

nounced and for the most part adhered to[52] the principle that agreement by competitors about prices is inherently unreasonable, regardless of the price level which may be established thereby or the effects which may be brought about upon profits and business activities.[53]

The courts have also shown a relatively uniform willingness to condemn collusive restraints, such as boycotts, which are intended to work specific injury upon nonparticipating enterprises. In considering other types of collusive self-restraint by businessmen, however, they have not established similar explicit presumptions of unreasonableness.

[52] This principle, first applied in the Trans-Missouri Case in 1897 (*United States v. Trans-Missouri Freight Association,* 166 U.S. 290) and fully discussed in the Trenton Potteries Case in 1927 (*United States v. Trenton Potteries Company,* 273 U.S. 392), was reiterated in 1940 in the Socony-Vacuum Case (*United States v. Socony-Vacuum Oil Company et al.,* 310 U.S. 150) and is now regarded as firmly established. In the Appalachian Coals Case, however [*Appalachian Coals, Inc. v. United States,* 288 U.S. 344 (1933)], the Supreme Court refused to condemn a plan under which coal producers were to set up a central sales agency which would determine prices and selling policy and then appoint the participating producers as subagents to sell their own coal in accord with the uniform terms thus established. The Court's decision was based upon the grounds that the participants controlled a relatively small part of the supply in the markets to which their coal was shipped, that they could not be expected to control the market price, and that their efforts to improve their bargaining position might be regarded as reasonable in the light of the distress then prevailing in the coal industry. The Court's decision was influenced by the facts that the scheme had not yet gone into effect and that the government's case was therefore based upon inference from the structural characteristics of the plan. The Court retained jurisdiction in order to change its decision if evidence of unlawful effects was subsequently submitted. While the case indicates both an unwillingness to presume effects in advance and an unwillingness to apply the law severely against agreements in distressed industries, note must be taken of the fact that the Court based its decision upon refusal to see price fixing in this scheme rather than willingness to regard such price fixing as reasonable.

[53] This principle has been of crucial significance in the development of the American law concerning restraints of trade. By taking the opposite side of the issue, courts in various European countries have destroyed the vitality of comparable statutes. For example, the French criminal law once included provisions against price fixing which appeared to be severe, but, by making the offense depend upon whether or not the fixed prices were unreasonable, the French courts converted prosecutions into arguments over the reasonableness of charges. Thus French antitrust proceedings took on the complexity that characterizes efforts by American public-utility commissions to determine whether or not public-utility rates are reasonable. The effect was to make the French statute a dead letter. See Heinrich Kronstein and Gertrude Leighton, "Cartel Control: A Record of Failure" (1946), 55 *Yale Law Journal,* 300-301.

Instead, the question of reasonableness appears to have been resolved case by case in the light of the particular evidence. Because of this difference in treatment, perhaps, the prosecuting agencies have emphasized price fixing as an offense wherever they could find it and have interpreted as indirect price fixing other types of restrictions which were expected to influence prices. Thus the courts have frequently found it necessary to decide whether or not a restrictive program constitutes price fixing.

As a result of these peculiarities of procedure, the concept of price fixing has been broadened in the American law, the importance of price fixing has been magnified, and attention has been diverted away from other types of restriction which may be of equal or even greater economic significance. For example, agreements to restrict output are not likely to be prosecuted as unreasonable per se but instead are likely to be attacked upon the theory that their principal or even their sole significance lies in raising prices by limiting supply.[54]

Although, except in the case of price fixing, restrictive agreements which do not coerce third parties are not clearly defined as inherently unlawful, the courts have provided in particular cases precedents which go far to establish the actual content of the law against collusive restraints. Because of the limited scale of enforcement, there are gaps in the body of precedents and there are instances in which the legal standing of a practice can be ascertained only from the decisions in one or two cases. In recent years the scale of enforcement has been increased and the prosecuting agencies have contributed to a working knowledge of the meaning of the law by announcing policies of prosecution based upon opinions about that meaning. However, some parts of these policies have not yet been tested in the highest courts.

Because of these difficulties, it is not possible to offer a definitive statement of the types of restrictive agreement that are unlawful in the United States. Nevertheless, it is possible to formulate a working understanding of the law which is definite enough to serve as a rough guide to its meaning. The following classification of restrictive agreements that are probably illegal is intended for this purpose. It is based upon an analysis of prosecutions instituted by the Department of Justice:

[54] "The illegality of contracts limiting production is based on and measured by their effect on prices. . . ." Herman Oliphant, "Trade Associations and the Law," *Dun's Review*, November, 1938, p. 9.

I. Exclusion of competitors from the market.
   A. Agreement to preempt or deprive others of access to facilities for doing business, such as credit, materials, technology, labor, or transportation; or to afford such access to others only upon discriminatory terms. Those thus excluded or discriminated against may include:
      1. New enterprises.
      2. Competitors from outside the locality.
      3. Competitors who are not members of an association or recognized group.
      4. Competitors whose methods of doing business are unorthodox.
   B. Agreement upon exclusive or preferential dealing arrangements designed to impair access by competitors to markets.
   C. Agreement not to use specified channels of distribution, or to make exclusive use of certain designated channels.
   D. Agreement to undertake discriminatory price cutting designed to destroy competition.
   E. Agreement to exact discriminatory prices or terms that prevent or destroy competition.
   F. Agreement to require the purchase of certain goods or services as a condition of supplying others.
   G. Discriminatory patent pools designed to destroy nonparticipants.

II. Restriction of output or of purchases.
   A. Agreement to restrict production, sales, shipments, exports, or inventory accumulations.
   B. Agreement to restrict purchases or imports.
   C. Agreement not to construct or acquire additional equipment.
   D. Agreement not to use new processes or not to produce, sell, purchase, or use new types of materials or equipment.
   E. Agreement to limit research.
   F. Agreement to shut down or destroy existing equipment, or to acquire equipment from competitors for such purposes.
   G. Agreement not to produce low-cost products.
   H. Agreement to limit the quality or durability of goods sold or the extent of services rendered.

III. Division of markets.
   A. Allocation of territories in which to sell or purchase.
   B. Allocation of customers.

C. Rotation of bids or orders.

D. Agreement on proportion of total sales or purchases to be made by each concern.

E. Allocation of products to be made or sold or processes to be used.

IV. Price fixing.

A. Agreement upon selling prices or bids.

B. Agreement upon and enforcement of resale prices (except as specifically exempted by law).

C. Agreement upon purchase prices to be paid.

D. Agreement to fix price differentials, discounts, or important terms of sale or to designate groups of customers who shall be eligible for discounts.

E. Agreement to add arbitrary charges to sale prices or to make arbitrary deductions from purchase prices.

V. Elimination of opportunity or incentive to compete.

A. Agreement to sell through the same agents.

B. Agreement to pool profits.

VI. Coercion.

Agreement to use boycotts and other coercive devices to further any of the foregoing restraints.

THE EXTENT OF UNCERTAINTY IN THE LAW

The technique of incorporating broad prohibitions in a statute and determining their exact meaning by interpretations applied to particular cases has both advantages and disadvantages. The law is broad enough to be applied to new methods of doing business and to changing economic circumstances. The interpretative process permits a flexible application of the statute designed to recognize differences in the economic significance of similar practices in different industrial settings. Because illegality is determined primarily by effect, there is an opportunity to apply economic criteria of judgment as rapidly as they become available and thus to direct the evolution of the law toward economically desirable standards of conduct. If the statute contained a series of specific prohibitions of particular practices and of agreements about particular subjects, the ingenuity of businessmen would soon devise new ways of accomplishing restrictive ends, and the evolution of business methods would soon give the old prohibitions unforeseen consequences.

However, the exact meaning of broad statutory provisions is necessarily less certain than that of more specific ones. Until the courts have spoken, the application of the law to untested relationships is necessarily problematical. Moreover, in so far as the same patterns of conduct differ in legality from one case to another because of their different effects, the business community is likely to misapprehend what is forbidden because of false analogies. Such uncertainties work hardships in particular cases and make it necessary to do business under a hazard. Moreover, they impair the effectiveness of the law as a protector of the public interest; for where the boundary of unlawfulness is doubtful, the incentive to cross the boundary is increased.

Although uncertainty is inherent in this type of statute, it is less significant than businessmen often assert. Legal advice is readily available to most enterprises that do business on a scale sufficient to bring them under the Federal statutes. As precedents accumulate, old uncertainties disappear, so that the greatest difficulties are encountered upon a moving frontier of business practices. In some cases in which businessmen have asserted that the meaning of the law has not been clear, the difficulty has been due to a stubborn refusal to recognize that an inherently restrictive scheme cannot become legal by a mere change in the devices through which it is carried out.[55]

Critics who emphasize the uncertainty of the law about restrictive agreements rest their argument in part upon conflicting judicial opinions in cases that involve collusion. They point out, for example, that in the linseed oil case the Supreme Court condemned the circulation of price statistics, whereas in the maple flooring case it refused to do so.[56] The force of such criticisms is considerably less than is often asserted. In some instances the conflicting decisions are drawn from different decades, and in the intervening period there have been substantial changes both in business practices and in the composition of the courts. Differences of this type are unavoidable. Laws that are to be effective social instruments must have sufficient flexibility to cope with new ways of undertaking an old offense, and not even the oldest and simplest laws can escape the difficulties raised by the personal idio-

[55] The writer has seen a letter from the general counsel of a large corporation stating that the intent of a conference of executives after the defeat of this company in an antitrust case was to put the company's legal house in order but not to alter its business practices.

[56] *United States v. American Linseed Oil Company,* 262 U.S. 371 (1923); *Maple Flooring Manufacturers Association v. United States,* 268 U.S. 563 (1925).

syncrasies of judges. Moreover, some of the sharpest of the judicial differences are traceable, not to changes in the courts' views of the law, but to variations, stubbornly ignored by lay critics, in the facts presented for decision.[57] This is true, for example, of the decisions in the linseed and maple flooring cases. In the former case the evidence indicated that statistical devices had been used to destroy price competition, and accordingly the program was pronounced illegal.[58] In the latter proceeding the government's case rested upon evidence that the statistical program of the Maple Flooring Manufacturers Association was substantially the same as that in the linseed oil case and upon the contention that since the linseed oil arrangement was illegal, the maple flooring arrangement must likewise be so. The defense, however, presented uncontradicted evidence to show that, whatever might be the

[57] "Frequent meetings of competitors, whether at formal dinners or in informal conferences, followed by significant changes in prices ostensibly made by each competitor acting independently, are a sample of the sort of evidentiary facts which courts have not hesitated to use as a basis for inferring the legally operative fact, an agreement to fix prices. The legal consequences of murder do not attach to the fact that a man carrying a smoking pistol is seen emerging from a house in which another man is found dead. That is a mere evidentiary fact. The legal consequences of murder attach only to the ultimate or operative fact, viz., the unlawful killing of a human being with malice aforethought. But the smoking pistol is an evidentiary fact, from which, along with other evidentiary facts, the legally operative fact may be inferred. Just so, frequent secret meetings of competitors do not violate the Sherman Act. They are mere evidentiary facts, but, as such, along with other evidentiary material, they may justify an inference of the legally operative fact, viz., an implied agreement to fix prices. A failure to make and apply this elementary distinction between evidentiary facts and operative facts is the cause of much of the adverse criticism. . . ." Oliphant, *op. cit.*, p. 10.

[58] The program included identical contracts for the exchange of past sales, price lists, and price reductions in identified form through a central bureau. Telegraphic report was required when sales were made at prices other than the reported prices. The plan included monthly meetings with compulsory attendance. The whole program was enforceable by fines. After summarizing the facts the Supreme Court declared (262 U.S. 389-390): "Obviously they were not *bona fide* competitors; their claim in that regard is at war with common experience and hardly compatible with fair dealing." Commenting upon this decision, Herman Oliphant remarks: "The court merely held that, from the evidentiary facts before it, there was ample justification for the inference made in the court below of the operative fact, viz., an implied agreement to charge uniform prices. . . . It did not hold illegal any one of the devices employed by the Linseed Association for the exchange of trade information. It merely held that they, in the matrix of the other facts of the case, were evidentiary facts sufficiently tending to establish a contract to fix prices to sustain the decision appealed from. . . ." Oliphant, *op. cit.*, p. 11.

result of such a statistical undertaking in other industries, there were no restrictive effects in the maple flooring industry. The government having failed to prove the effects which alone make a statistical program objectionable, the Court found for the defense.[59] Variations in the effectiveness with which the government's cases are prepared, in the lines of proof offered, and in interpretations of the law by government attorneys are at least as significant sources of inconsistencies in enforcement of the antitrust laws as variations in the opinions of judges.

Allowing for such factors, the uncertainties of the antitrust laws as applied to collusive activities are not unduly great. So long as the ingenuity of businessmen is addressed to the discovery of new devices for restraining trade, there will be certain problems upon which judicial opinion is being crystallized and judicial interpretation is not yet certain.[60] There will also be occasions on which similar behavior is

[59] "It cannot, we think, be questioned that data as to the average cost of flooring circulated among the members of the Association, when combined with a calculated freight rate which is either exactly or approximately the freight rate from point of shipment, plus an arbitrary percentage of profit, could be made the basis for fixing prices or for an agreement for price maintenance, which, if found to exist would, under the decisions of this court, constitute a violation of the Sherman Act. But, as we have already said, the record is barren of evidence that the published list of costs and the freight-rate book have been so used by the present Association. Consequently, the question which this court must decide is whether the use of this material by members of the Association will *necessarily* have that effect. . . . We realize that such information, gathered and disseminated among the members of a trade or business, may be the basis of agreement or concerted action to lessen production arbitrarily or to raise prices. . . . But in the absence of proof of such agreement or concerted action having been actually needed and actually attempted under the present plan of operation of defendants we can find no basis in the gathering and dissemination of such information by them or in their activities under their present organization for the inference that such concerted action *will necessarily* result. . . ." (Italics supplied.) (268 U.S. 572 and 585-586.)

[60] ". . . But there may be contracts to do other acts directly or indirectly producing the result. Which of these are legal? With time enough, we could start at one end with the very act of charging uniform prices and arrange a scale or gradation of other acts causally related to the first with intervening differences in degrees of remoteness. At one end we would have acts *necessarily* resulting in uniform pricing and at the other extreme acts *all but incapable* of causing uniform pricing. Where along that range shall the line be drawn so that we may say that a contract to do those acts lying on one side of this line, while not a contract to do the very act of fixing prices, nevertheless has the same legal consequences as an out and out contract to fix prices, and that a contract to do those acts lying on the other side is

treated differently because of the varying effectiveness of prosecutors and judges. In general, such variations will show themselves in the acquittal of some persons who should have been convicted rather than in penalties imposed upon the innocent. Over a period of time there will be marked change in the concepts of the law, but at any one moment the attorneys to whom businessmen look for advice will be able to identify with reasonable assurance most of the offenses which the law condemns. However, there will be constant insistence that the laws are uncertain, because there will be a continuous desire to evade the statutes by subtlety of means or limitation of degree, accompanied by a continuous doubt about how far such evasions may be successful.

In coping with collusion, then, the substantive content of the antitrust laws is generally adequate. The broad language of the statutes is inclusive and flexible enough to take account of variations from industry to industry in the significance of the same device. Within the area to which the antitrust laws apply, an effective attack upon collusion is possible without amendment of the present statutes.

To substitute a detailed list of prohibited types of agreements for the broad prohibitions of the present law would be disastrous. A half century of experience has shown that the techniques of collusive action evolve and become more elaborate. This process would be greatly hastened if new collusive devices were exempt from the law and a premium were thus placed upon their discovery. Moreover, specific prohibitions cannot readily be used against types of agreement that are unduly restrictive under some circumstances but not under others.[61] To prohibit such agreements under all circumstances would be unreasonable. To prohibit them with qualifications designed to make them unlawful only where they produce restrictive effects would be to abandon the principle of specific prohibition. Thus qualified, a prohibitory law would require proof of unreasonable restraint accompanied by

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wholly legal? This is the exact problem which confronts us and is not less simple and not less difficult than indicated. . . ." Oliphant, *op. cit.*, p. 12.

[61] The difficulty was evident in the development of the Clayton Act. Planned as a codification of illegal practices, this statute actually forbade only one practice, interlocking directorates, without regard to its effect. The other prohibitions were made applicable only where the effect might be to lessen competition substantially or to tend to create a monopoly. In this form they are illogical, for if the Congress desires to prevent competition from being substantially lessened, there is no reason why it should prohibit only two or three of the many practices by which this result may be accomplished.

proof that particular restrictive devices had been used. The statute would be as uncertain as the Sherman Act but not as comprehensive.

Something would be gained, however, if the broad prohibitions of the antitrust laws were supplemented by codification of specific practices that are regarded as generally so restrictive in effect as to be typically objectionable. The types of agreements listed on pages 41 and 42 would be suitable for inclusion in such a code. Since even these agreements may not always be restrictive, it would be appropriate not to prohibit them outright but instead to make them prima facie unlawful and to place upon defendants the burden of proof in showing that any such specific agreement was not restrictive. A statute containing such a provision would reduce the possibility of judicial aberration in interpreting the law and would offer a limited satisfaction to those groups which demand that the law be clarified. But the gain would be modest in both respects. Most of the listed offenses are so clear that judges of varying minds may be expected to recognize and condemn them, and attorneys may be expected to advise their clients that such behavior is illegal. Subtler forms of restriction and types of activity which are ambiguous in effect provide the uncertainties in the minds of businessmen and judges alike; and since the difficulties of interpretation are inherent in the varying effects of the practices to be interpreted, no blanket prohibition of these subtler practices would be wise.

Business groups have frequently suggested that a procedure should be established under which programs of joint action could be submitted to an appropriate administrative authority for review prior to adoption and that programs not disapproved should then be exempt from the antitrust laws. The Federal antitrust agencies have experimented with such arrangements. During the 1920's the FTC established a procedure for holding trade practice conferences at which, under the supervision of the commission, members of an industry were allowed to declare that certain practices were regarded as illegal and others as objectionable.[62] At first the commission allowed wide latitude in the definition of objectionable practices, but early in the 1930's it reviewed the trade practice-conference declarations then outstanding, withdrew its approval of many of their provisions, and adopted a

[62] See Federal Trade Commission *Annual Report,* 1926, pp. 47-54. See also Federal Trade Commission *Annual Report,* 1929, pp. 30-54. For definition of Group I and Group II Rules, see Federal Trade Commission *Annual Report,* 1935, pp. 96-97.

cautious policy toward further approvals.[63] Today an industry's condemnation of practices that are not illegal is approved only where the commission is satisfied that no restrictive effect could conceivably be produced by the agreement.

In the late 1920's the Antitrust Division of the Department of Justice also experimented with advance approvals of proposed business arrangements. Informal submission of these arrangements to the assistant attorney general was followed, upon occasion, by his declaration in writing that he saw no objection to what was proposed and would not prosecute it.[64] After 1933 the practice was discontinued for a time. Subsequently, in the administration of Thurman Arnold, a related procedure was adopted by which, if plans were submitted in advance and were not disapproved, the Antitrust Division undertook that any subsequent proceedings would be limited to civil suits for injunctive decrees, to the exclusion of criminal prosecutions looking toward punishment.[65] In spite of the existence of such procedures, demands for more sweeping exemptions have continued to arise. One of the most recent is a proposal by the National Foreign Trade Council that international business agreements filed with the Secretary of State be exempt from the antitrust laws unless the Secretary finds them contrary to the foreign economic policy of the United States.[66]

It is impracticable to grant sweeping exemptions upon the basis of an advance review of business arrangements. In submitting their plans, business groups may be expected to state them as persuasively as possible and sometimes to underemphasize or omit aspects that the antitrust agencies would look upon with suspicion. Moreover, such submittals cannot be expected to include a comprehensive and dispassionate review of the environmental setting in which a particular arrangement is to be established and of the consequences which are likely to result from interaction between the arrangement and the environment.[67] Short of such a review, they can provide no satisfac-

[63] See Thomas Blaisdell, *The Federal Trade Commission*, pp. 95-98, Columbia University Press, New York, 1932. See also Federal Trade Commission *Annual Report*, 1931, pp. 6, 107.

[64] See *Annual Report* of the Attorney General, 1931, p. 21.

[65] See Thurman W. Arnold, *The Bottlenecks of Business*, pp. 144-149, Reynal & Hitchcock, Inc., New York, 1940.

[66] See *Resolution on International Business Agreements* adopted by the Board of Directors of the National Foreign Trade Council, Inc., Jan. 26, 1945.

[67] In a news release, May 18, 1939, the Department of Justice announced that while it had been frequently requested to advise business concerns in advance as

tory basis for determining the effect of the program and hence for determining its legality. Where the nature of the program is clear and pertinent aspects of the environment are well known, the antitrust agency probably can foretell the significance of what is proposed; but in such cases the business group, too, is likely to be in no doubt about the law. Advance opinions are wanted in borderline cases where the facts are not clear, where the legal issues are not yet determined, or where the results are likely to depend upon the spirit in which the plan is carried out. It is precisely in these cases that no satisfactory advance opinion can be given.

However, business groups that wish to protect themselves from punishment for exploring the frontier of the law are able to do so within the limits of existing procedures. Even without the acquiescence of the antitrust agencies, any such group can put these agencies on notice about its plans, and if the agency thus notified issues no warning, there is little possibility that its subsequent efforts to punish the participipants will be successful. After failing to act upon prior notice, an enforcement agency which comes to believe that the law is being violated has no practical alternative except to request that the illegal practice be discontinued and to enforce its demand, if necessary, by a judicial injunction. Formal recognition of this fact was the essence of Thurman Arnold's policy concerning prior review. It also marks the limit of a satisfactory policy. When efforts are made to go further, they cannot escape the dilemma that approvals will be either so conservative as to be meaningless or else so improvident as to jeopardize important aspects of the public interest.

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to the legality or illegality of actions or plans, it had "no authority to give advisory opinions with respect to specific agreements, the legal effect of which may depend more upon the manner in which they are carried out than upon the express terms in which they are couched."

III. EXEMPTIONS APPLICABLE TO PRIVATE AGREEMENTS

THE MOST SERIOUS defect in the present law about restrictive agreements consists in the undue breadth of the exemptions enjoyed by various groups. These exemptions fall into two classes. In the first are those which are incident to inadequate definition of the boundaries between competition and control. These will be discussed subsequently in the chapter that deals with the relation between the competitive policy and policies of public control. In the second class are exemptions that have developed without serious effort to establish public control in the place of competition. In some cases no control at all is provided. In others, the control legally established is negligible and, in practical administration, may be regarded as nonexistent. Thus the effect of this class of exemptions is to permit unchecked private collusion.

FOREIGN TRADE

Foreign traders have been made largely exempt from the law against restrictive agreements. The Webb-Pomerene Act, passed at the FTC's suggestion at the end of the First World War,[1] permits businessmen to act together in export trade so long as they do not thereby raise prices or restrain trade within the United States and do not restrict the competition of exporters with whom they are in competition. Such groups must be registered with the FTC and must supply it upon request with information about their organization and conduct. If they go beyond the limits set by the statute, the FTC has authority to recommend a suitable readjustment of their business and, if they do not adopt its suggestions, to report them to the Department of Justice for prosecution.

This exemption was originally granted upon the theory that trade in foreign markets is often cartelized and that joint action by American exporters is necessary to enable them to compete with foreign cartels.[2]

[1] Export Trade Act of 1916, 65th Congress (40 Stat. 516).

[2] The Federal Trade Commission's *Report on Cooperation in American Export Trade* was presented to Congress on June 30, 1916. The commission expressed confidence "that the enactment of such legislation as that outlined above will permit

Apparently the statute contemplated two types of joint action: first, establishment of joint facilities by concerns which individually would be too small to carry on a foreign business and, second, attainment of greater bargaining power in marketing American products abroad. The limitations of the statute and the FTC's surveillance were regarded as sufficient safeguards for domestic consumers and independent exporters. The interests of foreign consumers were disregarded.[3]

The Webb Act has had unexpected results.[4] Until 1944 surveillance by the FTC was purely nominal.[5] The time of only one employee was

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the development of the cooperative organization which must take place if the manufacturers and producers of the United States are to compete with foreigners on more equal terms in export trade. It is also confident that this essential development can be obtained without harmful effects on the domestic market and without prejudice to the interests of American concerns which conduct their export business outside of any combination." (Vol. I, p. 381.)

[3] In the House of Representatives debate on the bill, Congressman Howard asked, "My question is this: How far does this bill let loose these concerns on this side? I am not concerned with the situation on the other side. I am concerned with this side. How far does the bill let them loose on this side?" (53 Congressional Record 13680.)

"Shortly after the passage of the Act the Department of Justice had occasion to suggest that a proposed dissolution of the U.S. Steel Corporation be limited to the domestic activities of that company on the expressed theory that its foreign activities would be proper if carried on by an entity qualified under the Webb-Pomerene Act. The Supreme Court, commenting on this proposal, said, 'We do not see how the Steel Corporation can be such a beneficial instrumentality in the trade of the world, and its beneficence be preserved, and yet be such an evil instrumentality in the trade of the United States that it must be destroyed.'" [*United States v. U.S. Steel Corporation,* 251 U.S. 417 (1920), p. 453.] See S. Diamond, "The Webb-Pomerene Act and Export Trade Associations," *Columbia Law Review,* Vol. 44, November, 1944.

[4] In August, 1946, the Foreign Trade Subcommittee of the Senate Special Committee on Small Business reported that the advantages to small business that had been expected to accrue from participation in export associations had rarely materialized, "that only rarely and under special circumstances can small business benefit from the Webb-Pomerene Act, and that on the contrary the preponderant effect of the act seems to have been to facilitate the concentration of industrial power in the hands of large enterprises to the detriment of small existing or potential competitors." See *Small Business and the Webb-Pomerene Act,* report of the Senate Foreign Trade Subcommittee of the Special Committee to Study the Problems of American Small Business, pursuant to SR. 28, Aug. 21, 1946, pp. 3-4.

[5] The first formal action under Sec. 5 of the law was not taken until Jan. 27, 1940. The commission then issued a recommendation for readjustment of the business of Pacific Forest Industries, an export trade association. See TNEC Monograph No. 6, *Export Prices and Export Cartels,* pp. 129-131.

spent upon this work. Reports by Webb associations were formal and often meaningless and the activities of the associations were not investigated by the commission. Thus the Webb associations were left to their own devices. Instead of acting together to compete against foreign cartels, the strongest of them apparently used their bargaining power to make international cartel agreements with foreign producers. They became devices to apportion the trade of the world on a monopolistic basis rather than to increase the American share of it by competition with other national groups.

Moreover, foreign dealings sometimes were not segregated from domestic except in form.[6] The copper export association, for example, was made up of concerns that produced in the United States most of the world's copper supply, and through their foreign subsidiaries controlled nearly all the rest. Its export prices and export policies apparently determined domestic prices and domestic supplies.[7] In some in-

[6] This problem was foreseen in argument against the bill in both House and Senate. Senator Cummins argued that ". . . it is utterly impossible to disassociate the activity of an association organized for export trade and the industries carried on for consumption within the United States. . . . It is perfectly evident that it would be impossible to give any corporation in this country the power to control the exports of a particular commodity without affecting the price in the United States; it could not be done." (56 Congressional Record 175, 182.)

In the House, Congressman Morgan stated: "I lay down this proposition, and that applies to the whole of the bill, that if we allow a combination to control the price abroad, the export price will affect the price at home. There is no escape from that conclusion. If export trade is controlled arbitrarily, which it will be, the great combinations will fix the price at which they sell abroad, and if you fix the price abroad that will affect the price at home." (55 Congressional Record 3573.)

[7] In a *Summary Report on the Copper Industry* (Mar. 11, 1947), the Federal Trade Commission discusses domestic and export prices during the operation of Copper Exporters, Inc., and concludes, "Apparently the cartel's export price was the controlling factor." (Pp. 13-14.) An investigation of the interrelated activities of Copper Institute, Inc., and Copper Exporters, Inc., by the commission was nearing completion in 1932 when prices broke in the depression and the cartel disintegrated. (P. 15.)

See also TNEC *Hearings,* Part 25, pp. 13110-13217, and Leslie T. Fournier, "The Purposes and Results of the Webb-Pomerene Law" (1932), 22 *American Economic Review,* 18.

"A particularly interesting series of copper prices began on April 12, 1929. On that day, domestic copper was quoted at 19.025 cents per pound and export copper 19.625 cents per pound. The quotations on April 13 were identical. April 14 was a Sunday. On April 15, the domestic price fell to 17.775; the export price was still 19.625. On April 16, domestic copper was unchanged at 17.775, but export copper dropped to 18.300. *These prices remained identical on every single business day from April 16, 1929, to April 15, 1930* [italics supplied]. On the latter date, both

stances associations that joined international cartels were given agreed shares of foreign markets upon condition that they would protect their foreign colleagues from independent American competition. Moreover, their willingness to stay out of the rest of the foreign market was sometimes due to the fact that foreign concerns undertook to limit exports to the United States.[8]

The difficulties are inherent in the nature of the problem. Wherever the United States produces an appreciable part of world supply and does an appreciable export business, export policy cannot fail to have domestic repercussions; and concerns united for export are unlikely to forget the prices and terms of sale they have agreed upon when they turn to the domestic market. To enforce the limits of the Webb-Pomerene Act would be to nullify the statute.

The Department of Justice is now prosecuting Webb associations for participation in international cartel agreements,[9] and the FTC has undertaken an active review of their practices.[10] Since ordinary prosecutions under the Sherman Act may be invoked in addition to the mild procedure available through the FTC,[11] the Webb Act will be rela-

domestic and export prices fell precisely 4 cents per pound." See Senate Foreign Trade Subcommittee of the Special Committee to Study the Problems of American Small Business, *op. cit.* (based on TNEC *Hearings* cited above), p. 77.

"It is ridiculous to suppose that it was a mere coincidence that the thirteen or fourteen important sellers of the metal on the domestic market (who were also members of Copper Exporters, Incorporated, through their affiliations with the producers) had an unvarying quotation day by day for three hundred and sixty-five days." (Fournier, *op. cit.*, pp. 18 and 31.)

[8] See *United States v. United States Alkali Export Association, Inc. et al.*, complaint, Mar. 16, 1944, Southern District of New York.

[9] See *United States v. Electrical Apparatus Export Association et al.*, complaint, May 16, 1945, Southern District of New York; the association was dissolved by consent decree on Mar. 12, 1947. See also *United States v. U.S. Alkali Export Association et al.*, cited above.

[10] In a report to the Senate Special Committee to Study the Problems of American Small Business, the commission advised that "fifteen associations recently investigated, now filing papers with the Commission, have had agreements with foreign producers at one time or another. Some of these have been canceled by the parties or made inoperative by war conditions. The Commission is now conducting inquiries involving the operation of these agreements." (Senate Foreign Trade Subcommittee of the Special Committee to Study the Problems of American Small Business, *op. cit.*, pp. 14-15.)

[11] On May 21, 1945, in *U.S. Alkali Export Association et al. v. United States* (325 U.S. 196), the Supreme Court held that exercise of the power conferred on the Federal Trade Commission by Section 5 of the Webb Act is not a prerequisite to a suit

tively useless for restrictive purposes so long as the antitrust agencies police the Webb associations vigorously. In practice, export associations will ordinarily be unable to adopt restrictive practices without exceeding the limits of their legal exemption and thus exposing themselves to prosecution. Nevertheless, as a standing invitation to do what cannot be done, the Webb Act tends to encourage violation of the law. It should be repealed on this ground. Moreover, its repeal would be appropriate in an international program directed against international cartels, such as is proposed below.

Even if the Webb Act were repealed, the antitrust laws would not be wholly satisfactory as means of coping with international collusive activities. International business agreements are not wholly within American jurisdiction either in law or in practice. American enterprises may participate in collusive restraints of trade abroad and thereby contribute to the maintenance of restrictive business practices throughout the world without violating American law, provided the collusion does not directly pertain to American commerce. Foreign enterprises may maintain collusive arrangements abroad, as a result of which imports into the United States are restricted, and may, nevertheless, escape American jurisdiction, provided the goods are sold to innocent persons before the importation begins.[12] Arrangements that legally violate American law because they restrict American exports or imports or American domestic trade may be immune from punishment because the parties to them cannot be found within the jurisdiction of the United States. The facts about illegal restraints may be hard to ascertain because the illegal agreements are made beyond our national borders and the records which reveal these agreements are kept abroad. Where illegal restraints are detected, efforts to get rid of them may be ineffective because foreign governments will not en-

by the United States against export associations to restrain violation of the Sherman Act.

[12] See *United States v. Deutsches Kalisyndikat Gesellschaft et al.*, consent decree entered Feb. 27, 1929, Southern District of New York. Reported in CCH *Federal Trade Regulation Service,* 7th ed., Supp. Vol. IV, par. 4188. Par. 4 of the decree directs: ". . . no provision of this decree shall be construed to prevent defendants from selling and delivering all or any part of their potash salts outside of the United States to a corporation organized under the laws of any country other than the United States regardless of any stock ownership or other interest in said corporation by any or all of the parties hereto; or to prevent said corporation from selling and distributing in the United States such potash salts so acquired, through usual facilities for sale and distribution. . . ."

force the decrees of American courts with reference to the portions of the scheme which lie outside American jurisdiction. Moreover, in some cases there are conflicts of law under which contracts illegal in the United States are enforceable elsewhere or the American demand for competition is inconsistent with a foreign regulatory policy.

Such difficulties establish a *de facto* exemption for restrictive agreements in international commerce which is substantial in amount and which is independent of the Webb Act.

Difficulties of this kind cannot be overcome by a single country. An effective remedy can be provided only by the collaboration of the principal trading nations in a common international program directed against international cartels and similar collusive restraints of trade. In view of the wide differences from country to country in forms of government, laws, administrative procedures, and economic philosophies, it is impracticable to entrust the prevention of international collusion to an international enforcement agency or to formulate a uniform statute capable of adoption by each country. The only feasible method of developing international cooperation is for governments to agree upon policies of preventing international private restrictions and to incorporate the agreements in treaties which bind the signers to enforce these policies within their several jurisdictions by whatever methods are most appropriate there. The cartel program incorporated in the draft charter for the International Trade Organization pledges the signatory governments to prevent international business arrangements that burden trade, and provides that an international office for business practices shall be established to promote the further development of international collaboration toward this end.[13] Adoption of such a program would strengthen the American laws against collusion in their international aspects.[14] It would presumably require the United States to prevent export associations from imposing such burdens upon

[13] See Chap. 5 of the *Havana Charter for an International Trade Organization*, Department of State Publication 3117, Commercial Policy Series 113 (Mar. 24, 1948).

[14] It is possible, of course, that the effort to develop an International Trade Organization may break down and, if so, that a large part of the trade of the world may be carried on by governmentally supported private cartels. It is also possible that state-trading may spread until it becomes characteristic of a large part of international trade and of the domestic trade of the most important foreign countries. Such developments would pose the question whether retaliatory measures of state-trading or of state support for collective private action were needed in American foreign trade. The question cannot be answered now, for lack of knowledge of the scope and severity of the problem.

international trade, even though these burdens fell wholly upon foreign competitors and customers and were therefore not illegal under the Webb Act. Appropriate repeal or modification of the Webb Act would be desirable,[15] even though a case without illegal domestic repercussions would be unlikely to arise.

COOPERATIVES

Another substantial exemption from the law against collusion has been granted to agricultural producers under the Capper-Volstead Act and the Cooperative Marketing Act.[16] The first of these statutes allows farmers, planters, ranchmen, dairymen, and nut and fruit growers to act together in collectively processing and marketing their products, provided that this collective action is organized in accord with cooperative principles set forth in the statute and provided that, as measured by value, more than half of the transactions are in the products of members of the cooperative. The second law authorizes original producers of agricultural products, when engaged in collective processing and marketing, to collect and disseminate statistical and economic information. These activities are exempt from the antitrust laws, but the Secretary of Agriculture is required to prevent them from unduly enhancing the price of agricultural products.

The scope of the Capper-Volstead exemption is limited not merely by the fact that it applies to original producers only but also by the requirement that every grower have one vote or, alternatively, that

[15] For a contrary point of view, see E. S. Mason, *Controlling World Trade*, McGraw-Hill Book Company, Inc., New York, 1946. In a section dealing with the U.S. State Department "Proposals for Expansion of World Trade and Employment," Professor Mason declares that while from par. 1, Chap. IV ". . . it might be presumed that export and import associations are included in the business agreements against which action is proposed, it is made clear in paragraph 2 that only restrictions imposed by 'a private *international* combination or agreement' are in question." (See pp. 61-65.)

Even under Professor Mason's interpretation, however, obligations are implied which may extend beyond the present limits of the Webb Act. As the Federal Trade Commission interprets the act, an agreement between an export association and a foreign cartel for allocation of foreign markets is not illegal unless American domestic trade or the export trade of independent American exporters is restrained. (This interpretation has been challenged by the Department of Justice, and the courts have not yet decided the matter.) Yet such an arrangement would be international and probably would be regarded as inconsistent with the draft charter.

[16] Capper-Volstead Act, 42 Stat. 388, 67th Congress, 2d Session (1922). Cooperative Marketing Act, 44 Stat. 802, 69th Congress, 1st Session (1926).

returns upon capital be limited to 8 per cent. Organization along such lines is not generally attractive to commercial enterprises.

The theory underlying the exemption for agricultural cooperatives is that farmers are typically too small as individuals to market their products economically or to enjoy equality of bargaining power. While family enterprises may be efficient in operating farms, or may be desirable on social grounds even though inefficient, processing and marketing call for larger units. Therefore, there is economy in permitting farmers to act together to sort, grade, and store their crops, to make butter and cheese, to pack eggs and fruit, to route products to the most profitable markets, and the like. Because agricultural markets are so large and farm units so small, even a farmers' cooperative is unlikely to have enough members to attain the power to restrain trade.

Since this theory depends upon the smallness of the producer, it might logically be applied to petty manufacture and petty trade as well as to farming. Indeed the decision of the Supreme Court in the Appalachian Coals Case applied a similar principle to a nonagricultural market.[17] However, the breadth of markets and the generality of small-scale production in agriculture are much greater than in other economic activities, and supplies are influenced more by weather and less by man. If public policy is to permit or even encourage agreement among small producers, the agricultural field is the only one in which a blanket exemption appears to be plausible.

Even here, however, the problem has proved to be more difficult than was contemplated in the legislation. While it is true that the great staple crops have been beyond control by even the strongest cooperatives, agricultural specialties can be and have been tightly controlled. Cooperatives have flourished chiefly in the production of fruits, vegetables, and dairy products which come from limited producing areas where it is possible to organize most of the producers.[18] The econo-

[17] In this case a civil suit under the antitrust laws was instituted against a central marketing agency (and its 137 participants) which had been established by a group of producers of bituminous coal. The case was adjudicated before the agency's marketing activities had actually begun. Stressing the competitive nature of the coal industry, the small proportion thereof which would use the agency, and the agency's apparent incompetence to restrain trade, the Supreme Court refused to enjoin the plan, but retained jurisdiction in order that it might consider further complaint if experience ran counter to its predictions. See *Appalachian Coals, Inc. v. United States,* 288 U.S. 344 (1933).

[18] In the case of milk, although production is widespread the legal barriers which surround metropolitan milk markets and the perishable nature of the product itself

mies of joint action are substantial, as was expected, but dominance of the market is also frequent, contrary to predictions in Congress when the laws were passed. The cooperative form of organization has not removed the incentive for associated producers to set prices as high as they can and to maintain these prices by restrictive activities.[19]

The looseness of the cooperative law has increased these difficulties. Although Congress apparently thought about small farmers who operate family farms, it set no limits of size or structure upon the privilege of joining cooperatives. In states such as California, where the growing of some kinds of fruits and vegetables is passing rapidly into the control of large corporations whose holdings resemble agricultural factories, joint action by these corporations to market their crops is permissible under the agricultural laws. Since joint action may include processing, their immunity apparently extends not merely to the marketing of the raw product but also to such operations as canning and to marketing the products of these factory processes.

Moreover, the boundaries of the cooperative exemption are not clearly defined. Permission to act together in marketing a commodity conveys the right to determine prices and sales policies jointly and hence constitutes an exemption from the law against collusive activities in restraint of trade.[20] That cooperatives are subject to the law against price discrimination has been judicially determined.[21] It is not clear

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have created a series of separate markets, within each of which the producing group is small enough to be organized.

[19] See *United States v. The Borden Company et al.*, indictment, Nov. 1, 1938, Northern District of Illinois, Eastern Division; *United States v. The Borden Company et al.*, 308 U.S. 188 (1939). See also *United States v. California Fruit Growers' Exchange et al.*, indictment, Dec. 17, 1941, Southern District of California, Central Division.

[20] Even before the cooperative statutes, Section 6 of the Clayton Act exempted members of cooperatives from the law against collusion by providing that agricultural organizations instituted for the purpose of mutual help and not having capital stock nor being conducted for profit shall not be held to be illegal combinations in restraint of trade. This provision presumably does not guarantee the right of cooperatives to carry on activities that are not inherent in the cooperative relationship and that are generally forbidden by the Sherman Act and the Clayton Act.

[21] Section 4 of the Robinson-Patman Act specifically provides that nothing in the law against price discrimination shall prevent a cooperative from paying patronage dividends. By implication, therefore, the law is otherwise applicable to cooperatives. In *Quality Bakers of America v. Federal Trade Commission*, 114 F. (2d) 393 (1940), the petitioners claimed exemption from Section 2 (c) of the Clayton Act as amended by the Robinson-Patman Act, by reason of Section 4 of the latter act. They con-

to what extent cooperatives enjoy the right to use coercive tactics against independent producers, to violate the provision of the Clayton Act which forbids tying contracts, or to monopolize agricultural markets. The question of monopoly was raised in Congressional debates before the Capper-Volstead Act was passed, but sponsors of the bill dismissed it by asserting that the situation could never arise. This prediction has proved erroneous. Various cooperatives appear to have achieved a degree of control over the supply of particular products which might constitute an unlawful monopoly if exercised by an industrial enterprise in a manufacturing industry.[22] The importance of the monopoly question is enhanced by the existence of federations of cooperatives; for if the exemption permits cooperatives to collaborate with other cooperatives in marketing, the possible effectiveness of re-

tended that the two organizations were cooperative associations within the meaning of Section 4. The court denied the validity of the argument, saying, ". . . We deem it not necessary to consider whether either or both organizations mentioned are cooperatives within the meaning of the statute because we hold that Section 4 does not authorize cooperative associations to engage in the practices forbidden by Section 2 (c) of the Act, nor except them from its provisions. There is nothing in the language of the statutes which warrants such a conclusion or such a forced construction. The action and debates in Congress to which we have been referred so indicate." (P. 400.)

[22] The California Fruit Growers' Exchange is an example. In 1941 this cooperative marketing organization included more than 200 packing units and represented more than 15,000 growers of citrus fruit in California and Arizona. It marketed fruit through representatives in about fifty cities throughout the country. According to its annual report in the year which ended Oct. 31, 1940, the Exchange shipped more than 70 per cent of the total packed citrus fruit originating in California and Arizona, and about 69 per cent of the loose fruit. It controlled more than 80 per cent of United States shipments of packed lemons.

This record was not exceptional. From 1930 to 1940 the Exchange shipped nearly 76 per cent of American shipments of packed citrus fruit.

In 1941 the Exchange and various codefendants were indicted under the antitrust laws for attempting to eliminate competitors and fix prices for citrus fruits through acquisition of control over organized auction markets, manipulation of supplies, and the use of boycotts. The corporate defendants pleaded *nolo contendere* and paid fines of $80,000. They also accepted a consent decree enjoining the unlawful practices complained of. See *United States v. California Fruit Growers' Exchange et al.*, indictment, Dec. 17, 1941, Southern District of California, and a companion civil complaint filed Nov. 16, 1942, in the same court and terminated by consent decree on Nov. 18, 1942. The cases are reported in CCH *Trade Regulation Service*, 9th ed., Supp. 1941-1943, par. 52,879.

strictive policies and the likelihood of monopolistic control are substantially increased.

Privately organized restriction of output, coercion of competitors, and monopolistic pricing are no more desirable in agriculture than elsewhere.[23] A competitive policy cannot accept such developments in agriculture on the theory that they are necessary to offset the monopolistic buying power of industrial enterprises that purchase agricultural products. Instead, such a policy must seek to retain competition among agricultural producers and to restore it among their customers in so far as it has been impaired. The economies of joint marketing by farmers should be retained, and there need be no objection to the development of cooperative organizations which have a bargaining power comparable to that of competitive industrial enterprises. But a problem arises when the cooperative exemption which goes thus far is permitted to go further.

The cooperative statutes should be tightened in several respects. First, their benefits should not extend to any corporation. This limitation probably would be sufficient to prevent great agricultural enterprises from enjoying the privileges that were intended for family farms. Second, the special privileges of the cooperative law should be available only to agricultural cooperatives that admit to membership only persons who are primarily growers of agricultural products. This change would prevent ordinary commercial enterprises from escaping the law against collusion in their processing activities by the mere device of becoming growers also. Third, the exemption for cooperatives should be so limited that it permits voluntary agreements (for example, about selling terms) but not coercive activities, attempts to monopolize, or monopolies. Being subject to the law against coercive restraints, a cooperative would be prevented from oppressing other farm producers. Being subject to the law against monopoly, it would be limited in its acquisition of bargaining power.

Since the foregoing suggestions are relatively simple and would prevent the most serious of the potential abuses, they may be regarded as a minimum program. However, cooperatives thus limited would still

[23] For the *Ad Hoc* Committee on Agricultural Price Supports, Elmer J. Working, of the University of Illinois, reported in 1946, "Agricultural market price supports tend in the long run to defeat their purpose of increasing agricultural income, and also to destroy the ability of prices to direct production, distribution, and consumption." See Papers and Proceedings of the 58th Annual Meeting of the American Economic Association, 36 *American Economic Review Supp.* 818 (May, 1946).

be free to restrict competition to a substantially greater extent than enterprises in manufacturing industries. To destroy this possibility while permitting farmers to enhance their bargaining power through cooperative organization is much more difficult. Nothing better than rule-of-thumb devices is available. One such rule might provide that exemption from the antitrust laws shall not be granted to arrangements between cooperatives. This might be accompanied by a limit upon the proportion of the total national supply of a commodity which might be brought under the control of a single cooperative. Alternatively, the law might provide in general terms that no cooperative or federation of cooperatives shall be large enough to control the supply of a product that reaches the national market.

Cooperatives engaged in marketing aquatic products enjoy a similar exemption [24] and present a similar problem. Those who are permitted to market such products jointly may range in size from proprietors of small fishing boats to large corporations that own fishing fleets. Fish-marketing corporations are exempt in their processing and canning operations as well as in fishing. The benefits of the statute should be withdrawn from corporate enterprises (or at least from all corporations except those that sell primarily to fish-processing companies), and liability for coercive restraints and for monopoly should be restored. Because of the dispersion of fishing activities and the relatively small scale of fishermen's cooperatives, there appears to be no need for supplementary requirements like those proposed above for agriculture.

With such changes, the present provisions of the cooperative statutes against undue enhancement of prices would become less important. Nevertheless, they should be retained, particularly in the case of the agricultural laws, for whatever usefulness they may have in cases of excessive bargaining power which fall short of monopoly. For greater effectiveness they should be reworded so that action can be taken not only in case of an unreasonably high price but in case of any price or marketing method unreasonably oppressive to the buyer. If any use is to be made of these provisions, however, their administration should be entrusted to the FTC rather than to the Secretaries of Agriculture and Commerce. Experience has shown that in the hands of the latter they are not utilized. The Secretary of Agriculture has not proceeded against farm cooperatives, even though the practices of some of them

[24] Fisheries Cooperative Marketing Act of June 25, 1934, 48 Stat. 1213, 73d Congress, 2d Session.

have been so restrictive as to induce the Department of Justice to proceed under the antitrust laws.[25]

AGRICULTURAL PRODUCTS

A much more serious breach in the antitrust laws was made by the agricultural marketing agreements legislation of the 1930's. As part of a general policy designed to raise the relative prices of farm products, the Agricultural Marketing Agreements Act gave the Secretary of Agriculture authority to enter into marketing agreements with processors, producers, associations of producers, and others engaged in handling any agricultural commodity or product thereof, and exempted such agreements from the antitrust laws.[26] This statute clearly applies not only to farmers and farm organizations but also to industrial establishments that process farm products and to traders who sell either the original or the processed products. Its field, therefore, is not only agriculture, but substantially all of the food industry and considerable portions of other industries as well. There are no limitations upon the subject matter of the agreements except the general provision that they shall carry out the purposes of the law. The exemption from the antitrust laws is complete, including not only the right to create combinations in restraint of trade but also the right to coerce competitors and to create monopolies. Protection for the public interest rests entirely in the unchecked and unguided discretion of the Secretary of Agriculture. His assent is necessary to give effect to the original agreement, and he is authorized subsequently to obtain reports from the participants and to examine their business records in order to determine whether the agreement has effectuated the policy of the act and whether the exemption from the antitrust laws has been abused. By withdrawing his approval of an agreement, he can restore the applicability of the antitrust laws.

In practice, the Secretary of Agriculture has made no investigation directed to the discovery of abuse of the antitrust exemption and has revoked no marketing agreement on this ground. His inquiries have

[25] See *United States v. The Borden Company et al.,* 308 U.S. 188 (1939); *United States v. California Fruit Growers' Exchange et al.,* consent decree entered Nov. 18, 1942 (reported in CCH *Trade Regulation Service,* 9th ed., Supp. 1941-1943, par. 52,879).

[26] Agricultural Marketing Agreements Act, 50 Stat. 246 (1937), 75th Congress, 1st Session.

sought to determine whether agreements were being carried out and whether they were accomplishing the purposes of the Agricultural Marketing Agreements Act. In practice, too, the Secretary has sometimes used other portions of the agricultural legislation, which give him the power to issue marketing orders, in such a way as to extend the application of marketing agreements to persons who were unwilling to enter into them. Thus agreements have become devices by which, through the authority of the Secretary of Agriculture, groups concerned with marketing agricultural products have been able not only to accomplish their own purposes in disregard of the antitrust laws but also to enforce these purposes upon their reluctant competitors.

Agricultural marketing agreements have actually been approved only for commodities that are produced locally by specialized enterprises. They have not been applied to the great nation-wide crops. The largest group of agreements (more than thirty) have governed various local milk markets. Other important agreements have covered citrus fruit, peaches, pears, and potatoes. With the exception of one agreement for bees, one for hops, and two for nuts, all others have dealt with various fruits and vegetables. Only in the case of milk has the Secretary used his power to make an agreement applicable to groups of processors. Corporations engaged in making and selling evaporated milk have been parties to one such agreement, and dairy companies have been parties to a considerable number.

The practices incorporated in agricultural marketing agreements have included fixation of prices, limitation of the amounts or percentages of output which may be sold, diversion of products to supplementary markets, and various other directly restrictive programs. The central purpose of the agreements has been to raise the prices of the commodities covered thereby, and the most usual technique has been to prohibit the sale in ordinary commercial markets of some portion of the amount produced. The first agreement, for example, which regulated the handling of walnuts, provided that a portion of the crop should be defined as surplus and should be surrendered to a control board which might dispose of it by export, by gift or sale to charitable institutions, or by other means not likely to upset the market for the rest of the crop, but specifically not by domestic commercial sale as unshelled walnuts.[27]

[27] See Order No. 1, Regulating the Handling of Walnuts Grown in California, Oregon, and Washington, effective Oct. 15, 1935.

The approved marketing orders have granted powers of administration and often substantial powers of enforcement to central administrative agencies composed of processors and handlers. These agencies usually have been given authority to apply the formulas through which the price and the quantity for sale are to be determined, to apportion shares in the market, and to make marketing regulations. The Secretary's surveillance over them has been typically limited to a requirement that they make annual reports of their activities.

This statute is objectionable by standards that are fundamental to any public policy. Its purpose, to improve the relative well-being of farmers, calls for no challenge. Its method, however, is to sanction devices that reduce the amount of the available food supply [28] and is therefore inherently restrictionist. Its standards of price are based, like those of other farm legislation, upon comparative prices of farm products and other commodities in a base period; and such standards are notoriously incompetent both to take account of changes in farm income because of increases in productivity and to maintain a suitable relationship among farm prices themselves.[29] Its administrative tech-

[28] In some cases food has been diverted from ordinary commercial channels to export, charity, or markets which are not commercially important. Since such food is not wholly wasted, diversion is preferable to reduction of supply. Indeed, a wholly wise and benevolent control board might use such a device to provide a decent minimum livelihood for all persons in spite of inequality of income; and elements of such an adaptation of the program have been apparent in food-stamp and school-milk distribution plans. Nevertheless, diversion typically has been managed for its commercial benefits to producers, not for its physical benefits to poor consumers; and much of what has been diverted apparently has been transferred to less important uses. For example, human food has been diverted as stockfeed or as industrial raw material, even though human nutrition is deficient and substitute products are available for the other uses.

[29] The *Ad Hoc* Committee on Agricultural Price Supports concludes that ". . . parity prices, as they are defined by law, do not constitute a balanced set of price relationships for agriculture. Thus, if prices of cotton and wheat are maintained at 92½ and 90 per cent of parity, production of these commodities tends to be unduly encouraged and consumption to be held at too low a level. On the other hand, some commodities should have prices well above parity in order to obtain sufficient production." (Working, *op. cit.*, p. 820.)

T. W. Schultz, professor of agricultural economics at the University of Chicago, asserts that absolute price relationships burden agriculture, and that "It would be wholly accidental if the relative prices of any past period, whether the years are 1910-1914 or a more recent period, proved to be appropriate for later years. We begin in error when we try to establish, as is done under the parity-price formula, a relationship among the prices of farm products, and a relationship between farm

nique is to entrust exercise of public power to persons who are privately interested, without adequate provision for public surveillance. The substantive content of agreements made under its authority is determined by bargaining between representatives of one private interest and a single public official, under procedures which are designed to afford some protection to those who enter into the agreements but not to the consumers of the product. This official's power is sometimes used to enforce arrangements thus made upon dissenting minorities within the producing groups, and thus to give those arrangements the full effect of public laws without the precautions attached to the enactment and enforcement of ordinary laws. Official discretion is not appreciably limited by law nor subjected to judicial or administrative review.[30]

This legislation should be repealed, and the marketing agreements derived from it should be terminated.[31] It is improbable that the best way to aid farmers is to use public power to adjust the prices of farm products; but this question, like the question whether farmers should be given special public aid, lies outside the scope of the present discussion. Whatever is done in this direction should be undertaken in full

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and nonfarm prices, that happened to prevail during a particular past period. *To guide farmers in their production, prices of farm products must be forward, not backward, in their orientation. They should be based on current and expected supply and demand, not upon some historical situation.*" T. W. Schultz, *Agriculture in an Unstable Economy*, pp. 257-258, McGraw-Hill Book Company, Inc., New York, 1945. See also Professor Schultz's *Redirecting Farm Policy*, pp. 15-19, The Macmillan Company, New York, 1943.

30 Judicial review is limited by the fact that the interest of victims of such arrangements is so diffused as to make litigation by them improbable, and is so indirect that the courts would be likely to reject their appeals as insubstantial. Since the act grants authority to the Secretary of Agriculture rather than to the President, the Chief Executive has no statutory authority over the Secretary's policies under it. See Sec. 8b of the act, cited above.

31 Nothing in this discussion is intended to prejudge the possibility, stressed by some students of agricultural problems, that under governmental leadership private cooperative means might be found to promote economies in the marketing of farm products; for example, by eliminating wastes in terminal markets for fruits and vegetables or by reducing the wasteful duplications of service in the delivery of milk. Unlike the present agricultural-marketing-agreements program, such projects would have purposes sufficiently constructive to accommodate the ordinary safeguards of public law and good administration—explicit formulation of purpose, adequate voice for all interested parties, disinterested administration, and adequate supervision. Far from promoting such programs, the present law retards them by offering farm producers the alternative of public sanction for crude monopolistic ventures.

awareness that the prices of farm products are equally important to those who receive them and those who pay them, and any public action in this field should be carried on through impartial instrumentalities and with full public responsibility for the results. So long as many people are undernourished, such programs should eschew measures that reduce the total supply of food. Even if restrictions designed to raise prices are retained, a sharp distinction should be restored between privileges granted to farmers who are expected to be the beneficiaries of the program and privileges for commercial processors, for whom no special benefit is intended. No theory that monopolistic profits in the processing of farm products may trickle back to the original producer should be sufficient to justify exemptions from the antitrust laws or special governmental controls over markets for the benefit of processors.

RESALE PRICE AGREEMENTS

Another exemption from the antitrust laws is contained in the Miller-Tydings Amendment[32] to the Sherman Act and in the underlying state laws which make the amendment effective. Under these laws resale price contracts are exempted from the Sherman Act and from the Federal Trade Commission Act.[33]

Prior to this legislation there had been many efforts by sellers to control the prices at which their customers resold products bearing the seller's brand or trade-mark; but such resale price control had been held illegal because it circumscribed the right of distributors to set prices as low as they might wish.[34] Since a manufacturer retained the right to select his customers and was free to refuse to deal with those whose resale prices were regarded as too low,[35] some sellers found it possible in practice to prevent price cutting by their distributors. They were not free, however, to warn, intimidate, and coerce, nor to make resale price policy a matter of contract; and these limitations

[32] Miller-Tydings Act, Pub. No. 314, 75th Congress, 1st Session, 1937 (15 U.S.C.A.).

[33] The exemption does not cover the Wilson Tariff Act and the Tariff Act of 1930. It is probable, however, that if an effort were made to attack resale price contracts upon imported goods under these laws, the broad language of the statutes would be interpreted in the light of the Miller-Tydings Amendment.

[34] See *Bobbs-Merrill v. Straus,* 210 U.S. 339 (1908); *Dr. Miles Medical Company v. John B. Park & Sons,* 220 U.S. 373 (1911); and the *Bauer & Cie v. O'Donnell,* 229 U.S. 1 (1912).

[35] See *United States v. Colgate Co.,* 250 U.S. 300 (1919); *Harriet Hubbard Ayer, Inc. v. Federal Trade Commission,* 15 F. (2d) 274 (1926).

helped make the maintenance of resale prices relatively ineffective in most cases.

The pressure to amend the law came from two groups. Certain manufacturers wished to control resale prices on the theory that price cutting by distributors reduced the manufacturer's volume of sales.[36] Certain distributors wished their competitors subjected to resale price control because they disliked price competition at the distributive level.[37]

The former group contained owners of trade-marks who had won a considerable public reputation for their products. Some of them had established their prestige by inducing distributors to promote their trade-marks. These concerns feared that the reduction of distributors' margins which would accompany price cutting would lead distributors to push rival goods. Other producers had won their reputations by advertising campaigns addressed directly to consumers. They feared that some distributors would use their products as low-priced leaders and thus make other distributors reluctant to continue to sell the goods.[38] Both types of manufacturers wished to prevent price-cutting

[36] The Federal Trade Commission, in its *Report on Resale Price Maintenance* (Dec. 13, 1945, p. LIV), concluded that "Minimum resale price maintenance was originally advocated by manufacturers of highly individualized, trade-marked, trade named, or branded products as a means of protecting them from unrestrained price cutting among dealers to whom the products were sold outright." See also J. L. Brown, *Trends in Resale Price Maintenance,* Comparative Law Series (new series), Vol. 1, No. 2 (February, 1938), p. 37, U.S. Department of Commerce; and W. A. Kates, "We'll Fight to Keep Fair Trade Because We Know It Works," *Sales Management,* July 15, 1941, p. 18.

[37] The Federal Trade Commission report, p. LIV (cited above) also concluded that when the laws were enacted by states and the Federal government ". . . enactment was urged almost entirely by a few well-organized dealer groups as a means of eliminating price competition both of dealers using the same methods of distribution and of dealers using new and different methods of distribution."

On June 16, 1938, John A. Goode, Chairman of the National Advisory Fair Trade Committee, wrote in the *NARD Journal* that price competition among retailers, which he regarded as without economic or logical justification, was to a large extent eliminated by the resale price laws, but that these laws increased competition among manufacturers, who were enabled to keep their selling prices low by virtue of their control of production and costs.

[38] According to the usual argument, such a development has three stages. In the first, a few distributors offer an article as a leader and others are forced to reduce their prices upon it in order to make sales. In the second stage, continuation of leader selling offers no particular advantage because the low price has become general; and all distributors tend to curtail their purchases of the product because in-

distributors from jeopardizing their relations with their other distributors and thus with the public. For this purpose they wished to be able to preserve a comfortable spread between their own selling prices and the prices of their products in resale markets.

Ostensibly the distributors who wanted resale-price maintenance were concerned only with extreme forms of price cutting. They pointed to the fact that well-known products are sometimes sold at or below cost to attract trade, and they argued that through such tactics the dominance of chain stores was increased and the solvency of small independent distributors was threatened. There was little substance to these arguments. Indeed, leader selling is not confined to large distributive organizations but is generally prevalent, and the small concern can match the large one more readily in such tactics than in display advertising, radio advertising, and various other forms of promotion.[39] The price cutting which jeopardized small distributors was based partly upon broad chain-store policies of distributing merchandise at low margins of profit[40] and partly upon special buying advantages enjoyed by the chain stores, which made low resale prices profitable. It was not due to loss-leaders. Logically, moreover, an effort to cope with loss-leaders would require a program designed

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sufficient profit is to be made upon it. In the third stage, the manufacturer has lost his distributive organization, and his good will has suffered because the public no longer finds it easy to buy his goods.

[39] The effectiveness of leader selling as a competitive weapon depends not upon the size but upon the diversification of the enterprise which uses it. A concern with many lines may cut prices upon one of them and thereby wreck a competitor of comparable size who is wholly dependent upon selling that one line. The problem of power which springs from such phenomena is discussed below, in the chapter on coercion.

[40] In *United States v. The New York Great Atlantic and Pacific Tea Company, Inc. et al.*, 67 F. Supp. 626 (1946), the court noted that "From 1929 to 1936, A & P programs for net profit rates ranged from .0271 in the middle western division to .0382 in the eastern division. Central western division was directed to operate on a net profit basis of 1½ to 2% including nonretail profits. If results were satisfactory Hartford [president of the New York corporation] believed the plan should apply to all divisions. The division was authorized to 'plough back into Cincinnati whatever is necessary in the way of a drastic sales campaign' in order to bring the unit up to par with the rest of the division."

The court further notes, "In opening supermarkets, the gross profit rate, Mr. Hartford directed, should not exceed 10%, though the company's average supermarket expense rate then was 11.97%. He said 'establish them on a low gross profit and maintain them on this basis until we feel that their security has been definitely fixed.'"

merely to prevent exceptional price reductions upon particular items,[41] whereas resale-price maintenance is a much broader program, under which highly profitable prices upon a single item or many can be made uniform for all distributors. Distributors who favored the latter type of program were attempting to protect or increase their traditional markup by preventing any price cutting whatsoever at the distributive level.

The demand for resale-price maintenance is great in certain industries in which there is great leeway for price competition to reduce cost to the consumer. Manufacturers whose good will has been used to obtain higher prices rather than greater volume are peculiarly vulnerable and feel a need to take special care to preserve the good will upon which their success depends. Where distribution is characterized by high margins and a wide variety of products with a slow rate of turnover, the structure of markups can be readily and profitably upset by a distributor who concentrates upon selling a few products rapidly at low prices. Accordingly, the clamor for resale-price maintenance has been greatest in such industries. In the drug and cosmetic industries, where support for resale-price maintenance is strong, inflated prices upon simple preparations popularized by intensive advertising and by other forms of intensive sales effort have encouraged multiplication of producers and of brands, have overloaded the shelves of druggists with differently packaged products containing the same thing, and thus have put a premium upon the cultivation of the good will of distributors by manufacturers.[42] Merchandising at low prices might upset much of the structure of these precarious industries.

The resale-price-maintenance laws were enacted primarily in re-

[41] Such a program was actually devised by retail grocery organizations. It consisted of a law preventing the sale of any commodity by a distributor for less than a stated minimum markup over purchase or replacement price. Where the markup was set low enough to be merely a protection against loss-leaders, there was much disappointment with the law.

[42] "Because of the difficulty encountered by the average consumer in comparing the merits of rival drugs and toiletries, competition between manufacturers has centered largely upon advertising, trade-marks, and attractive packaging. At the same time, it is to the manufacturer's advantage to do all that he can to enlist the active sales cooperation of the retailer in pushing his particular product. As a result many manufacturers have adopted the policy of guaranteeing attractive margins to wholesalers and to retailers by fixing minimum resale prices for their products under the provisions of state resale price-maintenance statutes (the so-called fair trade laws)." TNEC Monograph No. 1, *Price Behavior and Business Policy*, Summary, p. XXIV.

sponse to pressure from distributors in the drug industry, with some help from manufacturers of drugs and cosmetics and from distributors of tobacco products, books, and one or two other commodities. After decades of vain effort to persuade Congress to relax the antitrust laws, these groups turned to the state legislatures, where they were successful in obtaining laws that legalized resale-price contracts in intrastate commerce. The first such law was merely permissive,[43] but soon it became evident that few distributors were willing to peg their own resale prices if their rivals might undersell them. Consequently, the first state law was amended,[44] and the later ones enacted, to include a provision by which any distributor who sells an identified product for less than a contractual resale price of which he has notice is guilty of unfair competition, even though he may not have signed a resale-price contract. The effect of this provision is to enable a manufacturer and a single distributor to fix by contract the minimum level of price for all distributors throughout a state and to invoke the authority of the state government to enforce the arrangement.

After a considerable number of such state laws had been enacted, the Supreme Court of the United States upheld the constitutionality of the state legislation,[45] and the Congress, through the Miller-Tydings Amendment, authorized the use of resale-price-maintenance contracts in interstate commerce provided they are legal in the state in which the resale takes place.[46] Thereupon, most of the remaining states

[43] "An act to protect trade-mark owners, distributors . . . ," California Fair Trade Law, Chap. 278, Stats. of 1931, effective Aug. 14, 1931 (Gen. Laws, Deering, 1937, Act 8782).

[44] In 1933 the California Fair Trade Law was amended to include:

"Sec. 1½. Wilfully and knowingly advertising, offering for sale or selling any commodity at less than the price stipulated in any contract entered into pursuant to the provision of Section 1 of this Act, whether the person so advertising, offering for sale or selling is or is not a party to such contract, is unfair competition and is actionable at the suit of any person damaged thereby." (Ch. 260, Stats. of 1933, effective Aug. 21, 1933.)

By the end of 1938 the content of Sec. 1½ had been adopted by forty-two other states and the Territory of Hawaii.

[45] See *Old Dearborn Distributing Company v. Seagram Distillers Corporation,* 299 U.S. 183 (1936); *Pep Boys v. Pyroil Sales Corporation,* 299 U.S. 198 (1936).

[46] Loose ends have been left in both judicial and Congressional action. Treating the state legislation as though it merely permitted resale-price contracts, the Supreme Court's decision did not discuss the compulsory features of the laws. The Congressional law, which was enacted as a rider to the Appropriation Act for the District of Columbia, was not fully dovetailed with the state legislation. It author-

adopted resale-price-maintenance laws. Today resale-price maintenance is legal throughout the United States, except in Missouri, Vermont, and the District of Columbia.[47]

As has already been indicated, resale-price contracts, reinforced by the present state legislation, necessarily curtail price competition in resale markets upon all products to which these contracts apply. The size of the distributor's margin is determined by contract and made universal. The result is to divert distributors to competition in sales effort, in pricing goods not covered by contracts, and in providing various types of distributive services. Where contracts apply to most goods which distributors carry, only sales effort and service competition remain, and in consequence the costs of distribution are likely to rise. Moreover, there is apparently some tendency for new distributors to be attracted into the trade where the margins are generous, and for the average volume per distributive outlet to be correspondingly reduced.[48]

Among manufacturers, too, the resale-price laws have substantially reduced competition. In part this has been due to perversions of the law by distributors. Distributors' organizations have used boycotts, preferential salesmanship, and various forms of intimidation and per-

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izes only resale-price contracts which fix minimum prices, and it specifies that there must be not agreement among persons who are in competition with each other. Since the effect of the coercive features of the state laws is to give any vertical contract binding power upon distributors who are in competition with each other, the state laws to which effect is given by the national statute accomplish the very result that the national statute seeks to forbid. Moreover, in many of these state laws the prices which are legal are absolute rather than minimum prices, so that what the state law sanctions is not provided for in the national legislation, and vice versa. See *Final Report and Recommendations of the Temporary National Economic Committee,* Senate Document No. 35, 77th Congress, 1st Session, pp. 237-238.

[47] Congress has been repeatedly asked to legalize resale-price maintenance within the District of Columbia, but has not done so. The National Association of Retail Druggists credited President Roosevelt with stopping passage of such a law. See *NARD Journal,* June 1, 1939, p. 732.

[48] The Federal Trade Commission *Report on Resale Price Maintenance,* Dec. 13, 1945, noted this feature in its discussion of the English experience with resale-price maintenance: "In the confectionary industry it was observed, the allowance of wide margins by manufacturers resulted in an influx of retailers into the trade, causing reduced profits because of the further division of the existing business. . . . by 1937 there had been such an influx of dealers into the drug trade, especially of those handling other lines who regarded the margins on drug items to be generous, that manufacturers of proprietary drugs and medicines were asked to enter into a 7 year agreement to limit their sales strictly to chemists." (P. 563.)

suasion to induce reluctant manufacturers to issue resale-price contracts and to persuade them to make resale prices and margins satisfactory from the distributor's point of view.[49] The goal sought through such pressures is a standard markup for distributors, generously computed. Thus collusion, which is still illegal under the laws, has made resale-price-maintenance contracts more prevalent and their terms more uniform. It has tended to reduce or eliminate competitive variations in the discount and distribution policies of manufacturers.

So far as pressure from distributors is concerned, manufacturers remain free to compete in factory prices and to use price cutting at the factory as a device to engage in price competition at retail. In practice, however, resale-price maintenance provides machinery by which manufacturers can avoid such competition. The same distributors usually handle the goods of rival manufacturers; any manufacturer is free to enter into a resale-price contract with any distributor; and the terms of such a contract are binding on all other distributors within the state. Thus manufacturers can produce the effect of a horizontal price agreement among themselves if each one of them establishes, in

[49] An example of such practices is noted in an article, "Resale Price-fixing under the Fair Trade Laws," *Business Week,* Aug. 28, 1937, pp. 37, 44. The article states: "One thing is certain: even the strongest consumer demand built on an advertised reputation will avail a manufacturer nothing if he tries to buck the combined opposition of well organized dealers and strong competitive brands which are entrenched in the dealer's favor by stabilized prices.

"The sad experience of Pepsodent in California two years ago proved that. The fair trade laws had their birth out there among the independent retail druggists, and for a while Pepsodent strung along with them on a price maintenance policy. But then Pepsodent, which had attained its status as the biggest selling toothpaste by virtue of vigorous national advertising and the most rampant kind of price-cutting, decided to cancel its California price contracts and return to the policies on which it had ridden to fame. But no sooner did the company announce cancellation than Pepsodent went under the counter in practically every California drug store, and other druggists clear across the country, who were boosters for the fair trade law idea, made similar reprisal. Rapidly, other brands which were carefully cultivating dealer good will by strict price stabilization—notably Ipana—forged ahead and took Pepsodent's leadership away from it. Result: a few months later Pepsodent returned to the fold and brought with it a check for $25,000 to help the druggists support the cause of fair trade laws before state legislatures and Congress."

For a comparable experience in the liquor industry, see "Schenley Restores Price Contracts," *Business Week,* Sept. 3, 1938, p. 29.

For a brief discussion of such programs and techniques, see Federal Trade Commission *Report on Resale Price Maintenance,* Dec. 13, 1945: drugstore merchandise, pp. 166-218; beer, pp. 426-427; hardware, pp. 505-516.

a contract with some distributor, retail prices and discounts equivalent to those which that distributor is bound to observe, by contracts to which he is not a party, in his sales of the products of the other manufacturers. Pressure from distributors promotes uniformity in the discounts; the self-interest of manufacturers may easily lead to uniformity in the factory prices; and when the contracts are in effect, state law is available to enforce them. The effect of such a pattern is similar to that which would be produced by direct collusion among the manufacturers.[50]

The coercive features of the state laws are the principal sources of difficulty. If resale-price maintenance were merely permissive, it probably would be rare, for it could be undertaken only where a manufacturer wanted it and was strong enough to adopt it regardless of his rivals and where distributors dared take the risk of competition from their price-cutting competitors. A minimum program of amendment would be to change the laws so that no one who does not sign a contract can be bound thereby.

It would be desirable, however, to repeal all the resale-price-maintenance legislation, permissive as well as coercive. There is no more reason to protect distributors from price competition than to protect manufacturers. Neither is there any public advantage in protecting the good will of manufacturers from competitive impairment so far as that good will is expressed in high prices. The only manufacturers who may have a reasonable claim for this kind of protection are those who suffer loss of their distributive channels because of leader selling; and if there is an appropriate protection for them, it consists in measures directed specifically against the leader device.[51]

[50] Without parallel action with their competitors, many manufacturers dare not issue resale-price contracts. A manufacturer of certain school supplies summarized the situation as follows:

". . . We should welcome the opportunity to apply quantity resale prices on all the items of both loose leaf and blank book lines as we have done in California but at the moment this seems impossible unless the other competing manufacturers adopt similar policies. Until such time, therefore, as this is done we can only embrace the opportunities which the law gives us to the extent of covering those non-competing items in our line which would not be seriously affected by the foot loose and fancy free prices of competing items of the other manufacturers." TNEC *Hearings,* Part 31-A, pp. 18162-18163.

[51] See pp. 163-164.

INSURANCE

In one special field, insurance, exemption from the antitrust laws has been recently granted by Federal statute in order to give the states an opportunity to continue their control of the insurance business. For many years insurance was supposed to be beyond the regulatory power of the Federal government because it was not a part of commerce.[52] During this period state regulation of insurance companies became general, and there was some state antitrust legislation applicable thereto.[53] A recent Supreme Court decision held that insurance companies are subject to the Federal antitrust laws.[54] Thereupon, the industry and some of the state regulatory bodies protested that Federal jurisdiction would nullify an established regulatory system.[55] Congress exempted insurance companies entirely from the antitrust laws until 1948, except for continued prohibition of coercive practices, and provided that thereafter states that had adopted state programs to prevent monopolistic restraints might substitute them for the Federal control.[56]

[52] See *Paul v. Virginia,* 75 U.S. 168 (1868-1869); *Hooper v. California,* 155 U.S. 648 (1895).

[53] States that have enacted antitrust laws, applicable to insurance, include Arizona, Arkansas, Iowa (other than life insurance), Kansas, Louisiana (fire insurance), Michigan, and Missouri. (R.S. 1919, Sec. 9671 of the Missouri code provides that it shall be considered prima facie evidence of violation if it is shown that an insurance company, or its agent or representative, in writing insurance has used or consulted any rate or rate book, card, etc., prepared, published, or furnished by any person, association, or bureau employed by, representing or acting on behalf of any other insurance company or association in and about the making and publishing of insurance rates for use in the state.) For a summary of such laws see *State Anti-trust Laws,* Vol. I, prepared by the Marketing Laws Survey, WPA (1940).

[54] *United States v. South-eastern Underwriters Association et al.,* 322 U.S. 533 (1944).

[55] See *Joint Hearing* before Subcommittees of Committees on Judiciary, 78th Congress, 1st Session, on S. 1362, HR. 3269, and HR. 3270; statement of A. V. Gruhn, manager, American Mutual Alliance, pp. 215-221; statement of Harlan Justice, deputy insurance commissioner of the State of West Virginia, pp. 475-484.

[56] Section 2(b) of the law provides that no act of Congress shall be construed to invalidate or supersede laws enacted by any state to regulate the business of insurance provided "That after January 1, 1948 . . . the Sherman Act . . . Clayton Act, and . . . Federal Trade Commission Act . . . shall be applicable to the business of insurance to the extent that such business is not regulated by State law."

Section 3 provides that until Jan. 1, 1948, the laws listed above, as well as the Robinson-Patman Act, shall not apply "to the business of insurance or to acts in the conduct thereof." Paragraph (b) of the section provides that nothing contained in the act "shall render the said Sherman Act inapplicable to any agreement to

This is an unpromising experiment which makes excessive concession to pressure from an industry that has learned its way about legislative halls. In most states antitrust laws have never been effectively enforced. There is no reason to assume that this record will be suddenly reversed. Moreover, the great insurance companies, organized on a national basis, present the same difficulties for state control as have been conspicuous in the cases of national railroads and giant manufacturing organizations. A transition period during which state regulations are brought into harmony with national law is an appropriate tribute to the past. Thereafter there appears to be no good reason why insurance companies doing a national business should be allowed to engage in monopolistic or coercive practices even if particular state governments are willing to sanction such practices. It is contended that the actuarial basis for insurance computations and the need to be certain of the solvency of each company constitute reasons for permitting agreement in determining premiums and other terms of insurance contracts. If this contention is sound, the need should be recognized by an appropriate exemption provided in Federal law, suitably limited in order to control tendencies toward excessive rates, and generally applicable throughout the United States. It should not be made to depend upon the varying conclusions of forty-eight state legislatures. Neither should exemption for this purpose become an excuse for exempting other types of restrictive and coercive action. The appeal to state rather than to Federal jurisdiction is merely an instance of demand for the control which is likely to be, not most appropriate, but least effective.

PATENTS

A pervasive exemption from the law against collusion is conveyed by the patent law, under which restrictive arrangements of various kinds can be included in patent licenses. Since this feature of patent law springs from the central fact that a patent grant is a limited monopoly, and since its causes, consequences, and cures are intricate, it will be discussed in Chap. VI as one aspect of the problem of patent monopoly.

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boycott, coerce, or intimidate. . . ." Public Law 15 (79th Congress, 1st Session, approved Mar. 9, 1945).

Subsequent action by the Congress postponed the effective date of the reapplication of the antitrust laws until July 1, 1948.

LABOR

A special problem arises about the relation between the competitive policy and the policy of collective bargaining. Labor organizations enjoy peculiar rights of joint action and of group pressure on behalf of their interests. The postulates upon which unions have been approved have been that the bargaining power of the employer is inevitably greater than that of the single employee and that the results of this unequal bargaining power are directly felt in intolerable conditions of work and life for employees. Collective bargaining is relied upon to restore a balance. In practice, however, collective bargaining techniques have been accepted more widely than would be necessary for this avowed purpose. Workingmen have been protected in the right to join unions but not in the right to refrain from doing so.[57] Unions have been allowed to grow, if they can, beyond the scale of operations of even the largest employer, so that they may include the entire work force of an industry or all persons who possess a particular type of craft skill throughout the country. Collective action by employers with reference to labor matters has been permitted upon an equally wide scale as an exception to the general rule against collusive activity on their part. So far as collective bargaining prevails, wages and working conditions are no longer adjusted by competition among persons on the same side of the market, but rather by negotiation and trials of strength between organizations representing opposite sides of the market. The power of labor organizations has been supplemented by the adoption of minimum legal standards for wages and working conditions, designed to set limits below which labor cannot be forced if its bargaining position is weak.

In any effort to maintain an equilibrium in economic society through the play of competitive forces, these departures from competition in determining the status of labor must be of major concern. Allocation of our most important resource, labor, is no longer possible on the basis of competitive wage adjustments. Full use of this resource will not readily take place where modification of wage levels would be neces-

[57] The Labor-Management Relations Act, 1947, Public Law 101 (80th Congress, 1st Session), departs from the previous trend of the law in this respect. Section 7 of the National Labor Relations Act is amended to protect the employee in his right to bargain collectively or "to refrain from doing so." Section 8 is amended by declaring the closed shop to be an unfair labor practice. The union shop is permitted under certain specified conditions.

sary to bring it about. Since wage adjustments necessarily influence price adjustments, the stickiness of wages goes far to prevent automatic reallocations of business effort and automatic changes in price levels. Moreover, resort to collective bargaining necessarily implies that labor organizations and employers' organizations have a definitely determined membership based upon accepted jurisdictional claims. In many cases jurisdictions are protected by admission requirements and in some cases by efforts to hold down the total number of persons admitted. As the labor market is thus divided into self-contained segments, freedom of movement from job to job and from industry to industry must necessarily be impaired, and adjustments of the use of our human resources to our changing needs must become less flexible.

Powerful labor organizations probably obtain for their members higher wages and better working conditions than would otherwise be provided; but if these unions exclude other labor from their more remunerative occupations, this excluded labor must accumulate in the less remunerative occupations, where wages are likely to be driven still lower by the overcrowding of the labor market.

In these respects the effect of labor organizations upon the labor market is similar to the effect of collusive agreements upon the markets for commodities. Nevertheless, there are important differences in the social impact of the two types of joint action.

1. There is no inherent probability that the businessmen who form a collusive agreement would be weaker than their customers if they should bargain competitively, and there is a strong probability that they will be stronger than their customers so long as they stand together. Individual workingmen are usually at a substantial disadvantage in bargaining with those who buy their labor; and although well-organized groups of workingmen are often stronger than small employers, there is no inherent probability that they will be stronger than the large enterprises or the organized groups of employers with whom they bargain. Thus labor organization does not necessarily tend toward inequality of bargaining power, and the absence of labor organization makes such inequality probable, whereas collusive selling by businessmen typically does tend toward such inequality.

2. The risks imposed by competition are more serious for labor than for business. Where competitive determination of wages and working conditions exerts great pressure upon the worker, the result may be a degraded family life in which the worker's productivity may be impaired by ill health, society may incur great indirect costs from disease

and poverty, and the worker's children may be deprived of basic necessities for physical and mental development. By contrast, where competitive price determination exerts great pressure upon businessmen, the result may be loss of property and of status as head of a business, but it is unlikely to reduce the level of family living below that of workingmen.

3. The most important aims of the organized labor movement, as distinguished from its methods and from perversions of purpose to which particular unions are sometimes subject, are consistent with the objectives of a healthy economy. Higher levels of income and higher standards of living, reduction of inequalities in the distribution of income, increase in the amount of leisure time, reduction of the dangers and strains associated with work—such labor objectives as these are among the legitimate goals of an economic system. In a healthy society the trend of workers' incomes should be higher and the trend of work should be toward shorter hours in a better working environment.

By contrast, restrictive collusion by business groups is not directed toward desirable social goals. In a healthy society, production would be enhanced, not restricted; prices would be reduced, not maintained; and profits would not be safeguarded, but would vary with business efficiency and with the necessity for incentives to induce businessmen to shift their activities in accord with changing social needs.

Personal incomes, in other words, are inseparable from basic social values, whereas business incomes are significant as instruments rather than as ends.

To say this is not to deny that many restrictive techniques used by labor groups are similar to those used by business groups, and have, in some respects, similar economic effects. But alongside the similarities are significant dissimilarities, which must also be considered.[58]

For this reason, the problems of public policy that cluster around the employment bargain are substantially different from those that surround the commercial bargain. The difference has been emphasized by the development of a public policy that encourages collective bargaining in labor relations, while it provides competition in commercial relations.

The relationship between these two policies is complex and, in large part, obscure. According to one view, "We must alter our labor

[58] *Cf.* Richard A. Lester, "Reflections on the 'Labor Monopoly' Issue," *Journal of Political Economy,* December, 1947, pp. 513-536.

policy or abandon our anti-trust policy. . . . If one big union is a *fait accompli* in, say, the automobile industry, that industry is all through as a competitive sector of our economy—and damned to full cartelization, if not to General Motors." [59] According to another view, labor organization may actually promote the competitive policy by reducing the power of business monopolies.[60]

This book will not attempt to grapple with the fundamental issue as to the extent and nature of the collective bargaining about labor relations which may be consistent with preservation of the competitive forces that make for reasonably full employment and a reasonable balance in the use of economic resources. To discuss this question adequately would require a volume as long as this one; and for much of the discussion the author has no special competence. Rather, the question raised here will be a more limited one: Assuming the desirability of collective bargaining in labor relations, how far can it be made consistent with a commercial competition that safeguards traders and preserves opportunities for the appearance of new men and methods? The discussion will presume that the policies that govern commercial bargains need not govern the employment bargain; and it will ignore the economic effects, good or bad, of collective bargaining with reference to labor, except as they may affect commercial competition. It will propose only such limits upon collective bargaining in the labor market as may be necessary to maintain the vigor of competitive processes in commercial markets. It will take for granted, for example, the price-raising and price-stabilizing effects that flow from wage increases and wage stabilization and will be concerned only to preserve competition as to the spread between the standard wage and the market price.

Even within these narrow limits, collective bargaining raises a problem. The ability of workers to obtain better wages and working conditions depends in part upon the profits of those who employ them. Therefore, labor unions show an increasing interest in the commercial success of employing groups. Some unions aspire to a share in the control of the management of industry. Others find it worth while

[59] Henry Simons, "Some Reflections on Syndicalism," *Journal of Political Economy*, March, 1944.

[60] John Ise declares (*Economics*, p. 416, Harper & Brothers, New York, 1946): "Certainly labor unions do prevent the highly organized and integrated industries from becoming intolerable autocracies. If there were no unions, a handful of corporation executives would dominate industry so completely that laborers could live only by their grace."

to increase the incomes of employers, particularly if wages are a substantial part of the total cost of the product. Few union leaders discriminate between restrictive and nonrestrictive methods of improving an industry's income.[61] Although the labor interest in profits will seldom support a curtailment of output that directly reduces the amount of work available for union members, it may support a collusive price increase that is associated with a wage increase[62] or a restriction upon new productive capacity which limits the opportunity for newcomers to obtain employment. Thus a union that operates in a particular industry may help raise that industry's prices and limit that industry's production at the expense of consumers generally.

Moreover, labor unions often participate in efforts to exclude commercial enterprises from a market. In some cases these efforts are directed against concerns which employ nonunion labor, and thus are incidental to union policies of maintaining and extending collective bargaining. In other cases they are intended to protect employers in a high-wage area by excluding goods made in lower wage areas, even though the latter areas may also be unionized.[63] In still other cases unions attempt to exclude outsiders and newcomers from the market regardless of the union status of their employees; for a particular labor group has an interest in performing the available work rather than seeing it go elsewhere. Where this latter interest prevails, the purpose

[61] An example of such discrimination is *Purchasing Power for Prosperity*, an economic brief prepared by Walter Reuther (then director, General Motors Department, UAW-CIO) in the contract negotiations between the union and General Motors, October, 1945. He stated: "The UAW-CIO demands not only do not conflict with the public interest, but actively promote the public interest. The easy way to get wage increases is to conspire with industry to get price increases from OPA, getting wage demands out of prices, at the expense of the general public. . . . We do not want our wage demands met out of price increases. Our letter of August 18 serving our demands on General Motors so stated." (P. 9.)

[62] See *United States v. The Borden Company et al.*, 308 U.S. 188 (1939).

[63] In the antitrust action against the Lumber Products Association of San Francisco, it was established that a group of millwork and finished lumber manufacturers contracted with a number of unions to grant a wage increase in exchange for an agreement on the part of the union group to prevent the sale and shipment to the bay area of products manufactured outside California. In his opinion Circuit Court Judge Denman said: "The manufacturer group circulated among the trade price lists and market reports which effected artificial and non-competitive prices for millwork and patterned lumber. These were enforced by the union group by picketing, work stoppages, and other means, preventing the use of materials purchased in violation of the contract." *Lumber Products Association, Inc. v. United States*, 144 F. (2d) 548 (1944).

is exactly analogous to business motives for similar exclusive policies and is unrelated to any intelligible program for improving the position of the whole body of members of the union. Any one of these types of exclusive policy on the part of a labor union may reinforce a program of exclusion undertaken by businessmen against commercial rivals; and the last type may express a complete harmony between the restrictive desires of business and labor groups.

Furthermore, labor unions often attempt to maximize the number of jobs for their own members by opposing the use of new productive methods which might lead to the discharge of some workers or might substitute relatively unskilled labor for skilled labor. In their mildest form such policies merely insist upon such safeguards as that equivalent jobs be found for displaced workers or that rates of pay not be reduced under the new process; in their most drastic form they seek to forbid use of the new process entirely. Since a union's interest is focused upon its own members, the character of such policies is seldom influenced by the probable effect of the new process upon employment in other occupations or upon the aggregate volume of employment. Frequently the union interest in preserving old methods runs parallel to and reinforces the interest of business groups which regard the proposed innovation as a threat to the value of their capital investments, an opening for new competitors, and a probable cause of so-called "overproduction."

It is difficult to fix a sharp boundary between labor relations and commercial competition. At one extreme, union efforts to exclude nonunion goods are almost as fundamental to the maintenance of labor organization in certain industries as the right to strike; and although they may handicap certain producers while the union is struggling for recognition, they tend to disappear when production has been generally unionized and collective bargaining about labor matters has become firmly established. At the other extreme, use of restrictive tactics to hold work for one group of union men rather than another contributes to no purpose of the union movement and is as persistent and as destructive of commercial competition as similar acts by groups of businessmen. Between these extremes are cases in which recognized labor interests in protecting wage rates and cushioning unemployment come into conflict with recognized public interests in technological progress and open markets. At these points the policies of collective bargaining and commercial competition are, to some degree, contradictory.

Such conflicts of policy cannot be met wisely by giving free rein to one of the interests involved. If labor groups are left free to restrict commercial competition as they may desire, the authority to monopolize labor may be translated into a monopoly control of markets, and collective bargaining about labor matters may be extended into collusive action by employers and employees about commercial matters. To preserve commercial competition, it is necessary to establish a well-defined boundary line for collective bargaining.

No satisfactory boundary now exists. The swing of the law has been from too little to too great an immunity for labor. Prior to 1914 restraints of trade were often discovered in labor disputes [64] and the Sherman Act was invoked as an instrument to police strikes and even to prosecute trade unions for endeavoring to "monopolize" a portion of trade and commerce, namely, the labor supply.[65] In 1914 Congress began the process of exempting labor from the antitrust laws by stating in the Clayton Act that labor is not a commodity and by providing that the antitrust laws did not forbid the lawful activities of labor unions.[66] Under this statute the Federal courts continued to issue injunctions against labor groups where union practices had been carried so far as to be, in the opinion of the judges, unlawful. For example, secondary boycotts were treated as violations of the antitrust laws.[67] In the 1930's the Norris–La Guardia Act [68] definitely forbade the use of injunctions in labor disputes, but certain proponents of this legislation asserted that it left untouched the power of the courts to apply the criminal, as distinguished from the injunctive, provisions of the law to labor activities.[69] In the Apex Hosiery (1940) and Hutcheson (1941)

[64] See *United States v. Workingmen's Amalgamated Council*, 54 F. 994 (1893); *Loewe v. Lawlor*, 208 U.S. 274 (1908); *Gompers v. Buck Stove and Range Company*, 221 U.S. 418 (1911).

[65] See *United States v. Frank J. Hayes et al.*, indictment, Dec. 1, 1913, District of Colorado. A *nolle prosequi* was entered on government request Jan. 8, 1916. See also *Hitchmond Coal and Coke Company v. Mitchell*, 202 F. 512 (1912), upheld by Supreme Court in 245 U.S. 229 (1917) on other grounds.

[66] Public Law 212, 63d Congress, 2d Session (approved Oct. 15, 1914), 38 Stat. 730-740. See Secs. 6 and 20.

[67] See *Duplex Printing Press Company v. Deering*, 254 U.S. 443 (1921); *Bedford Cut Stone Company v. Journeyman Stone Cutters' Association*, 274 U.S. 37 (1927).

[68] The Federal Anti-injunction Law of 1932 (47 Stat. 70:29 U.S.C., Par. 101-115).

[69] In the *Columbia Law Review*, Vol. 31 (March, 1931), pp. 385-413, Prof. Felix Frankfurter, in an article, "Congressional Power over the Labor Injunction," argued in behalf of the proposed antiinjunction bill. On p. 408 he posed the following question: "Is the denial of all adequate judicial remedies in case of an illegal strike a

cases,[70] the Supreme Court reconsidered the status of labor as defined in the Clayton and Norris–La Guardia Acts and announced a new rule of exemption for labor activities.

Two conceptions are involved in the present doctrine. The first is a distinction between commercial competition and labor relations. Under it, arrangements about the price or production of a commodity are classified separately from arrangements about wages, hours, and working conditions.[71] If it alone were the basis of the present law, trade unions would be free to use strikes and boycotts and to enter into agreements in order to improve working conditions, but not in order to raise prices, exclude nonlocal concerns from the market, or restrict production.

The second distinction is between labor groups acting alone and labor groups acting jointly with businessmen. If it alone were the basis of the law, a union could not only determine wages and working conditions but also fix prices; but the law might be violated if unions

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denial of due process of law?" His answer was, "This question is not pertinent, for the bill only withdraws the remedy of the injunction. Civil action for damages and criminal prosecution remain available instruments." Subsequently, as a member of the Supreme Court, Mr. Justice Frankfurter delivered the opinion in *United States v. Hutcheson* which declared that labor acting alone is exempt from the Sherman Act. In discussing the Norris–La Guardia Act this opinion states: "To be sure, Congress expressed this national policy and determined the bounds of a labor dispute in an act explicitly dealing with the further withdrawal of injunctions in labor controversies. But to argue, as it was urged before us, that the *Duplex* case still governs for purposes of a criminal prosecution is to say that that which on the equity side of the court is allowable conduct may in a criminal proceeding become the road to prison. It would be strange indeed that although neither the government nor Anheuser-Busch could have sought an injunction against the acts here challenged, the elaborate efforts to permit such conduct failed to prevent criminal liability punishable with imprisonment and heavy fines. That is not the way to read the will of Congress. . . ."

[70] *Apex Hosiery Company v. Leader et al.*, 310 U.S. 469 (1940); *United States v. William L. Hutcheson et al.*, 312 U.S. 219 (1941).

[71] Even before the court's opinion, the Department of Justice had adopted portions of the same view. Thurman Arnold, Assistant Attorney General, had repudiated the idea of using the antitrust laws to police strikes and had indicated that, in spite of majority opinions by the Supreme Court in previous cases, he would not prosecute secondary boycotts incidental to labor disputes. This announcement was made in a public letter to the Central Labor Union of Indianapolis, on Nov. 20, 1939. See Thurman W. Arnold, *The Bottlenecks of Business*, pp. 248-253, Reynal & Hitchcock, Inc., New York, 1940.

and employers acted together, even to ask consumers not to buy the products of nonunion manufacturers.

The present law is a combination of both elements. A union that acts alone appears to be exempt even when it fixes prices.[72] Business and labor may act together about labor conditions but not about commercial competition. Thus the effect of the judicial doctrine is not merely to exclude labor relations from the antitrust laws but also to make the illegality of monopolistic practices in commercial markets depend, not upon the nature of the practice nor upon its effects, but upon the organization which undertakes it. Labor unions enjoy an exclusive judicial license to do what others may not do.[73]

This is a serious breach in the capacity of the antitrust laws to prevent collusive restraints. As has been said above, a union's interest in promoting monopolistic practices by an industry at the expense of the rest of the community (and of the rest of labor) is similar to, although usually somewhat weaker than, the business interest. The public interest in avoiding such restrictions is not destroyed by assurance that some portion of the gain will be received by a labor group.

More dangerous still is that fact that a union with the power to restrain trade has a valuable service to sell. Where in the past restraints upon commercial competition have not led to higher wages, there may be a strong suggestion from employers that commercial restraints will have such results in the future. Thus a labor group may be induced to fix prices by threatening to withdraw labor from price cutters, not

72 "So long as a union acts in its self-interest and does not combine with non-labor groups, the licit and illicit under Section 20 [Clayton Act] are not to be distinguished by any judgment regarding the wisdom or unwisdom, the rightness or wrongness, the selfishness or unselfishness of the end of which the particular union activities are the means." *United States v. Hutcheson,* 312 U.S. 232. See also *Allen Bradley et al. v. Local Union No. 3, International Brotherhood of Electrical Workers et al.,* 325 U.S. 797 (1945).

73 In *Allen Bradley Company et al. v. Local Union No. 3* (cited above), the Court held that a combination of labor unions and business groups in restraint of trade was subject to the provisions of the antitrust laws, declaring that if such combinations can legally fix prices and divide markets, it would have been a futile gesture for Congress to prohibit price fixing by business groups alone. The Court comments: "Our holding means that the same labor union activities may or may not be in violation of the Sherman Act, dependent upon whether the union acts alone or in combination with business groups. This, it is argued, brings about a wholly undesirable result—one which leaves labor unions free to engage in conduct which restrains trade. But the desirability of such an exemption of labor unions is a question for the determination of Congress."

only when the union believes that price maintenance may forestall wage cutting, but also when it has reason to hope that its services will be gratefully recognized by a higher wage rate. When employers induce labor groups to impose restraints, the arrangement presumably includes joint action by business and labor such as is still in violation of the antitrust laws. However, success in blocking such developments by law is problematical, for the offer is not likely to be made directly and explicitly. The inducement will consist merely of an improvement of labor conditions, which in themselves lie outside the scope of the antitrust laws, and the restrictive activities will be undertaken by labor acting alone. To intervene successfully, the enforcement agency would find it necessary to look askance at all improvements in wages and working conditions and to prosecute them wherever they followed upon or were accompanied by union practices restrictive of commercial competition. Such a policy would be an interposition of the antitrust laws in labor matters running far beyond anything previously attempted. Yet unless it is successfully undertaken, nullification of the laws against collusion waits merely upon the adoption of a labor policy to do so for the rewards which may be expected to follow. The beginnings of this kind of policy have already been reported in the practices of various unions.[74] If such policies should become general

[74] In its May, 1941, issue, *Fortune* magazine says in an article dealing with the teamsters' union (AFL), "Beck's teamsters have created a very close approximation of the dictatorship of the proletariat but not along Soviet lines. For Beck is considered by many potent business men to be a force for stability and profits, since, when he signs up with a group of employers, his teamsters act to stamp out competition from any 'independent' who may try to cut prices, employ non-union labor, or otherwise deviate from the terms of the contract. He is a potent force in many industries. For example laundry prices are high in Seattle on account of the Teamsters' Union. The Associated Laundries of Seattle audit the books of the laundries. In charge of the Associated Laundries is William H. Short, one of Beck's right hand men. But Beck justifies the setup by pointing out that before the Teamsters organized the laundries there were a great many bankruptcies in the industry." "The IBTCWH of A" (Teamsters' Union), pp. 97-100, 136-142.

Similar policies appear in a 1938 amendment to the by-laws of Local Union No. 118 and Auxiliaries, Bakery and Confectionary Workers' International Union of America (AFL). It reads as follows: "Whenever in the judgment of the Bakers Local Union 118 any firm or combination of firms are engaged in unfair or unwarranted competition for trade and in the selling of Bakery products and the best interest of the Baking industry, it shall be authorized and its duty to have such practices stopped even to the extent of withdrawing our members from employment of such concerns as will persist in such detrimental and ruinous practices." (Article 6, Sec. 7.)

in the teamsters' union, the jeopardy to the antitrust laws would be as great as this union's control over the distribution of commodities. If similar policies should be adopted generally by unions, they might easily be sufficient to destroy the effectiveness of the antitrust laws.

A further danger, though a less general one, arises in such unions as have leaders susceptible to personal inducements. In these cases a payment to the union official may be sufficient to launch the union upon a policy of restricting commercial competition, and action under the antitrust laws may be impossible unless the existence of bribery can be discovered and proved. Moreover, if the union leader takes the initiative in demanding payment, the enterprises that pay may appear as victims of extortion rather than as fellow-conspirators. In that case, the employer is guilty of nothing and the union official is exempt from the antitrust laws.[75]

Another difficulty that arises from the exemption of labor is due to ambiguities as to the kind of organization that enjoys exemption. Trade unionism includes, not merely groups of manual workers, skilled and unskilled, but also organizations composed of persons who carry substantial professional and managerial responsibilities. Aircraft crews, steamboat pilots, and construction foremen are unionized, and industrial foremen are beginning to be so. Columbia River pilots have closed admission to their profession by rules analogous to the ordinary closed shop and by rigid restrictions upon apprenticeship. Foremen in the building trades are required to observe union rules, some of which prohibit the use of designated types of materials. The unionization of foremen in industrial establishments is under way. At present the distinction between union members and business executives is obscured only in sporadic instances. But among the questions which must be faced is the extent to which unionism may penetrate among employees who carry responsibility for sales policy. Union rules applicable to the selling process are already in effect in the case of milk and bakery drivers.

The related problem of the unionization of self-employed persons is more immediate. Fishermen who operate their own boats or who

[75] Until recently he probably would also have been exempt from the Anti-racketeering Act. See *United States v. Local 807 of International Brotherhood of Teamsters, Chauffeurs, Stablemen and Helpers of America et al.*, 315 U.S. 521 (1941). However, liability under this act was apparently restored by amendment in July, 1946. See Anti-racketeering Act of 1946, Public Law 486 (79th Congress, 2d Session, approved July 3, 1946).

have an interest in the catch, newsdealers who operate their own newsstands, cleaners and dyers, tailors, self-employed contractors, and other persons engaged in various forms of petty manufacture or trade—some of these are already organized in so-called "unions" and others may come to be. If they are regarded as businessmen, they may not act together to impose monopolistic restrictions upon commerce, but they may do exactly the same thing with impunity if they are regarded as workingmen. The question whether newsdealers should be permitted to impose a boycott upon the distribution of a newspaper in order to increase their charge for distributing it should be determined by the effects of the practice and not upon the basis of a decision as to whether such persons are workingmen or tradesmen.

Competitive policy should include enactment of a law distinguishing commercial competition from labor relations and subjecting unions fully to the antitrust laws in so far as their activities are directed toward control of the former. So far as difficulties can be foreseen and decisions reached, this law should make provision for the treatment of borderline problems, such as labor restrictions upon new processes. For example, reasonable efforts to cushion transitional unemployment and to share in the gains of technical progress might be permitted, but efforts to prevent the use of new processes might be made illegal. Problems incapable of immediate solution would necessarily be left to a further development of the rule of reason by the courts and later legislation by the Congress.

Two other problems that arise because of the labor exemption present greater difficulties. The first of these is the systematic waste of labor through union action. This problem differs from that of commercial competition in the fact that the union restrictions apply wholly to the number of persons employed, the payments which they receive, and what they do for the money. Some unions set fixed limits upon the amount of work that may be done in a day. Although in some cases the purpose is to prevent excessive toil, in others the standard performance is absurdly low and the union refuses to increase it as technological change enlarges potential output per man.[76] Some

[76] On a housing project at Clareton, Pa., in 1939, the plumbers' and steamfitters' unions apparently required that installation of a heating device which could be completed in a day and a half be stretched out to cover five days. This result was achieved partly by enforcing a slower working pace and partly by applying jurisdictional rules which required that a series of men perform different operations. See *Building*, Apr. 15, 1939, p. 9.

unions stipulate that a minimum number of persons must be employed, even though the work could be done satisfactorily with a smaller crew. This practice has its most extreme manifestation in the rule enforced by the musicians' union, that stand-by labor must be hired to do nothing if mechanized music is used,[77] and in the rule enforced by some branches of the teamsters' union, under which an interstate truck must take on a second driver at the edge of a city, ostensibly as a pilot through a town, or at least must pay the union the wages of such a person.[78] Such practices raise costs and prices and waste labor unconscionably.

Although the argument for action to prevent such abuses of union power is very strong, such reforms should be considered apart from the antitrust laws and even apart from the competitive policy. So long as collective bargaining is a fundamental part of public policy toward labor, the legal issues involved in such matters must be different from the issues of competition and monopoly that arise in commercial intercourse. Moreover, the economic issues are dissimilar. Less extreme examples of such labor practices often raise perplexing questions that are peculiar to the field of labor relations. Unreasonable limits upon permissible amounts of work and requirements that unnecessary labor be hired must be distinguished from efforts to prevent the stretch-out and speed-up. Duplications in the labor force, based upon the requirement that men be hired locally, must be distinguished from efforts to protect high-wage areas against low-wage competition from other areas. Such questions should be dealt with by persons who are expert in labor

[77] See complaint filed in U.S. District Court for the Northern District of Illinois, Eastern Division, on Aug. 3, 1942, in *United States v. American Federation of Musicians et al.*, par. 14, subsec. (h). The District Court ruled against the government, holding that the case grew out of a labor dispute as defined by the Norris–La Guardia Act [47 F. Supp. 308 (1942)]. This decision was affirmed without opinion by the Supreme Court on Feb. 14, 1943 (318 U.S. 741). However, the Lea Act, Public Law 344 (79th Congress, 2d Session), amended the Communications Act of 1944 to "prohibit certain coercive practices affecting radio broadcasting." Sec. 506 (a) (1) makes unlawful any attempt to force licensed broadcasters to employ "any person or persons in excess of the number of employees needed by such licensee to perform actual services." The constitutionality of the Lea Act was affirmed by the Supreme Court on June 23, 1947. (*United States v. James C. Petrillo,* 332 U.S. 1.) In subsequent trial of this case, the defendants were found not guilty.

[78] See *United States v. Local 807 of the International Brotherhood of Teamsters, Chauffeurs, Stablemen and Helpers of America et al.,* 315 U.S. 521 (1941).

policy and should be considered in the context of their complex effects upon other aspects of that policy.

The second difficult problem is that raised by the jurisdictional dispute. In a jurisdictional dispute an employer becomes the victim of the conflicting claims of rival labor unions. His business and the supplies his customers want are interfered with regardless of what he does, since he can satisfy one of the rivals only on terms rejected by the other. Jurisdictional strikes and boycotts interfere with trade for a purpose that has no value to the labor movement as a whole; they merely determine the relative power of particular unions within it. By general agreement these weapons are inappropriate in settling jurisdictional disputes. The rights and wrongs of a dispute are often obscure, and only persons familiar with the labor issues involved can safely attempt to determine the appropriate jurisdiction of each union. The Antitrust Division of the Department of Justice has argued, however, that the antitrust laws have a place in requiring that decisions be reached and enforced by other means than restraint of trade.[79] Such a requirement might add to the willingness of strong unions to negotiate a settlement and to observe it thereafter.

Unlike the problem of restrictive labor practices, the jurisdictional problem lends itself to this type of treatment. In insisting that strikes and boycotts be avoided in jurisdictional disputes, an enforcement agency need not concern itself about delicate substantive questions. Hence there is no strong reason for not using the antitrust laws as suggested. Nevertheless, such use probably should be avoided for the sake of coherence and consistency in the scope of antitrust action. Under the general theory by which labor relations are exempted from the antitrust laws, the interference with trade which results from a strike or boycott is not regarded as in itself sufficient to be a violation of law. Yet only such restraints are usually involved in a jurisdictional dispute. The principle underlying the use of the antitrust laws in such cases would necessarily be that strikes and boycotts are unreasonable restraints when they are used for an unreasonable purpose.[80] To ac-

[79] See "Should the Anti-trust Laws Be Applied to Labor?", an address by Thurman Arnold, Assistant Attorney General of the United States, before the American Labor Club, New York City, Jan. 27, 1940; also an address by Wendell Berge (then) special assistant to the Attorney General, in debate with Henry Epstein, solicitor general of New York, Mar. 28, 1940, at the Harvard Law School.

[80] Such, indeed, was the logic of the Antitrust Division in endeavoring to work out a rule of reason before the decision in the Hutcheson case.

cept this principle would be to face the necessity of working out a special rule of reason applicable to labor problems.[81] Logically it would lead to enforcement of the antitrust laws against strikes and boycotts having to do with amounts of work, size of work force, wage rates, apprenticeship, and other aspects of labor relations, when labor demands were clearly unreasonable. It is preferable to restrict the antitrust laws to commercial competition and to make these laws applicable to labor, not where strikes and boycotts are restrictive, but where the purpose or effect of labor's activity is a restriction upon commercial competition itself.

[81] The Labor Management Relations Act, 1947, amending Sec. 8 of the National Labor Relations Act, makes jurisdictional disputes and secondary boycotts "unfair labor practices" to be prevented under the general enforcement and procedural powers of the National Labor Relations Board.

IV. THE CONCENTRATION OF ECONOMIC POWER

THE PROTECTIVE FUNCTIONS of competition may be destroyed not only by restrictive agreements but also by undue concentration of economic power. Unless the total market is expanding, as enterprises become bigger their number is necessarily reduced. With fewer sellers, the buyer is confronted by fewer alternatives of business policy. Moreover, particular enterprises may become powerful enough to disregard the policies of their remaining rivals or to intimidate these rivals into conformity. Thus through growth in the size of the business unit the incentives which competition provides for business conduct and the protections which it affords to traders may be substantially reduced if not wholly eliminated; and a further reduction of competitive safeguards is probable because restrictive agreements can be more easily made as competitors become fewer and larger.

The damage done to competition by concentrated economic power is less revocable and potentially more extensive than that done by restrictive agreements. Whereas agreements that restrain trade can usually be destroyed without great difficulty even after they have remained unchallenged for a considerable period of time, large business units, once established, cannot be done away with except by a major reorganization. Whereas restrictive agreements are frequently upset by newcomers or by conflicts of interest among the participants, large business units are usually stable and tend to grow progressively larger. The utmost possible scope for restrictions that depend upon agreement alone—a series of industry-wide agreements reinforced by understandings that one industry will not invade another's field of production—would still permit competition between industries producing goods that are substitutes for one another. But if large-scale business organization should bring most business activity under the control of a few enterprises, competition could be eliminated within each business empire, and working alliances between the giant concerns probably would prevent each from competing with the others.

TYPES OF CONCENTRATION OF ECONOMIC POWER

There are three types of concentrated economic power, each of which imperils competition in a different way. One is derived from control of sales (or purchases) in a particular industry. It is customarily described as monopoly (or monopsony).[1] A second is derived from vertical integration on a scale sufficient to provide a compelling advantage over nonintegrated enterprises. Though the power of the vertically integrated concern is in some respects similar to that of monopoly or monopsony, it is expressed in tactics sufficiently different to justify separate discussion. The third type of power is that which springs from giant size. Where the great enterprise has concentrated its activities in a particular industry, gianthood is likely to be accompanied by monopoly; but the strength due to large size is also evident in concerns which have so diversified their activities that they do not exercise significant monopolistic control over particular markets. Indeed, in the large enterprise diversification may be one of the sources of economic power.

THE POWER OF MONOPOLY

Monopoly appears in its simplest form in industries that produce a relatively homogeneous product for sale in a relatively simple and homogeneous market. Its manifestations are more complex in cases in which the monopolist produces various products, in the sale of which he enjoys different degrees of monopoly power, and in cases in which a monopolized product is sold through several different channels of distribution to different types of ultimate users. But although the complex cases appear to be more numerous than the simple ones, little has been done to analyze them closely or to provide theoretical concepts appropriate to them. Economic theory, public policy, and law have been based upon study of the simple cases. Until the gap is filled, our understanding of monopoly problems will be seriously incomplete; but meanwhile there is no alternative but to base the present discussion primarily upon the traditional analysis.

The danger from monopoly of the simple type has long been recognized in law and public policy. It is evident in the power which an enterprise enjoys when it controls so much of a market that those who trade with it cannot readily find trading alternatives. This power is

[1] "Monopsony" means control of purchases; "monopoly," control of sales.

commonly expressed in the ability of the monopolistic seller to keep prices high and to maintain them by curtailing sales. It may also be expressed in deliberate reduction of the quality of what is sold and in lethargy toward improvement of processes and products.

Such tendencies appear long before complete monopoly is attained. With each increase in the proportion of an industry controlled by a single enterprise, the opportunity for the customers of that enterprise to go elsewhere is reduced. When the available alternatives become so limited as to be insufficient to meet the needs of any substantial number of the large concern's customers, the large concern acquires appreciable bargaining power.[2] This bargaining power can be used to raise prices without significant reduction in volume of sales. The inducement to use it grows with each increase in the proportion of the total supply controlled by the large enterprise.[3] In recognition of these characteristics of a preponderant economic position, both law and economic theory have long applied the term "monopoly" to concerns that control their industries without being the only sellers therein.

Monopolistic bargaining advantages may be enjoyed by more than one enterprise in the same industry. If activity is concentrated under the control of two or three large business units, if sales are not greatly

[2] If, for example, the sales volume of the large concern is 70 per cent of that for the whole industry, a transfer of one-seventh of the large concern's customers would represent an increase of one-third in the business of other members of the industry. Unless these concerns are capable of accepting so much new business without delay, a transfer on this scale would be difficult and slow, and therefore the large concern need not fear a loss of as much as 14 per cent of its sales to its competitors, even if its customers are dissatisfied. Bargaining power derived from this type of relationship grows with each increase in the percentage of the industry's sales controlled by the large enterprise and with each decrease in the amount of unused productive capacity controlled by its rivals.

[3] In a one-price market, the loss of profit upon sales foregone is offset by an ever-increasing share of the industry's aggregate gain from a larger profit per unit upon sales made at higher prices. The size that must be attained to make such a policy profitable is a function of three variables: the reduction of sales which will follow a given increase of price, the increase of unit cost incident to this reduction, and the expansion of supply from other sources which may be expected to counteract the price increase partially. The smaller each of these is, the smaller will be the percentage of the total output at which it becomes profitable to raise prices and accept a lower sales volume.

Where price discrimination is possible, its effect is to make price-raising policies profitable when smaller percentages of total sales are controlled than would be necessary for such a policy in one-price markets.

reduced by high prices, and if no one of the large sellers has a strong incentive to seek additional business as a means of reducing unit costs, each large enterprise, acting separately, may prefer a policy of high prices and reduced sales. Each large seller is likely to believe that aggressive competition will evoke aggressive retaliation by the other large concern and that to live and let live is more profitable.[4] Where each has a similar incentive for a policy of high prices, each is encouraged to adopt it by belief that the other is more likely than not to follow suit. Thus there is a tendency for the number of effective competitive alternatives to be reduced still further by adoption of similar selling policies. Moreover, collusion, explicit or tacit, becomes easier with each reduction in the number of competitors. As business units become few and large, the vigor of competition tends to be reduced and business policies tend to become monopolistic in character.[5]

The continued existence of a large number of small concerns alongside a single large one is no guarantee that there will be active competition. As has already been pointed out, the large enterprise may adopt monopolistic policies because of its preponderant size without regard for the number of the remaining competitors, provided only that these competitors cannot greatly expand their sales. Moreover, the disparity in size and power between the large business and its small rivals is likely to expose the latter to coercion and possible destruction by the former. Where the power to coerce is substantial, the small concerns lose their independence. Existing under the toleration of the large one, they follow its policies and are careful not to provoke its anger.

When one enterprise is large there is question whether an increase in the size of its rivals makes the market more or less competitive. On the one hand, every such increase reduces the total number of enterprises and increases the incentives to adopt collusive and restrictive

[4] This point of view is well expressed in a letter from I. G. Farbenindustrie to the Winthrop Chemical Co. (1934): ". . . a price war is of benefit only to the consumer, and the maintaining of a certain price level would be to the advantage of all competitive companies." Corwin D. Edwards, *Economic and Political Aspects of International Cartels*, Monograph No. 1, p. 12, Senate Subcommittee on War Mobilization of the Committee on Military Affairs, 78th Congress, 2d Session, Washington, D.C., 1944.

[5] Alfred Mond, organizer of Imperial Chemical Industries (ICI), has suggested that "Another great advantage of rationalization is the consideration that the larger and more powerful units become, the more easy it is to carry on trade negotiations." *Industry and Politics*, p. 213, Macmillan & Co., Ltd., London, 1927.

policies. On the other hand, as disparities in size and power are reduced, coercive leadership by the large concern becomes less probable. But the choice between one monopolist and two or more quasi-monopolists is not a choice between monopoly and competition. To maintain the vigor of the competitive policy, means must be found to keep competing sellers numerous enough and small enough to preserve both variety of alternatives and independence of action.

In the complex type of monopoly, which uses its power through several different market channels in sale of a variety of products to a variety of consumers, the effects of monopoly power are probably less uniform than in the relatively simple type of case which has been summarized above. Strength in one market may be used to increase strength in another; and the possibility of segregating and classifying customers, and of pitting different types of distributors against one another, may enhance the monopolist's ability to exploit his position to the limit of each buyer's capacity and willingness to pay. Alternatively, the need for internal congruity in the policies adopted for different products, channels of distribution, and classes of customers may induce the monopoly to refrain from pressing its advantage in dealing with buyers whose bargaining position is unusually weak; and differences in the products, markets, and distributive channels of a few large enterprises may make collusion relatively difficult. Thus the complex monopoly may be either harsher or milder than the simple one.

THE POWER OF MONOPSONY

A preponderant place for a single concern as buyer of a particular type of commodity results in an enhancement of power similar to that of the simple monopoly. As the buyer's proportion of the total supply increases, monopsonistic power grows and becomes the basis for control of buying prices, enforceable by curtailment of purchases.[6] In

[6] In 1927, the Federal Trade Commission found that no spot market for petroleum existed, but that most crude petroleum was bought by the large crude petroleum purchasing companies at the prices they posted at the oil wells. Ten crude purchasing companies belonging to the Standard Oil group, as well as seven large independents and several smaller independents, regularly posted prices for crude petroleum. See Federal Trade Commission, *Report on Petroleum Industry—Prices, Profits, and Competition,* 1927, pp. 105-107.

The TNEC reported that "in the early days of the industry crude oil was bought and sold in oil exchanges . . . in 1895 the Seep Purchasing Company of Oil City on behalf of Standard Oil Co. posted a notice that thereafter the prices paid by it

general, however, there is less to fear from concentrated buying power than from concentrated control over sales. Though the buyer may exploit the seller, he is likely to be cautious in using the types of restrictions that are most harmful to the general public.

Even an enterprise that buys most of the supply of one or more commodities is unable to reduce its purchases in order to keep buying prices down without first considering that the reduction may require a corresponding reduction in sales of its own product. Thus, in so far as the concern has competitive incentives to expand its sales, these necessarily will weaken the restrictive features of its buying policy. Moreover, although a dominant buyer may force prices low enough to bankrupt weak sellers, its aggressiveness is usually limited by a desire to keep enough sellers in business to provide a reliable source of future supplies. Thus in dealing with commercial enterprises, monopsony is likely to be less damaging to the public interest than monopoly. However, where those who sell to the monopsonist are individuals or families, the buying policies of the monopsonist may be aggressive enough to degrade the standards of living of the sellers. It is in such cases that monopsony power is likely to create the more serious public problems.

Furthermore, monopsonistic power is relatively rare. Since most materials and equipment are put to a variety of uses in various industries, most sellers are not dependent upon the demand from any one industry. Hence an enterprise that dominates one industry is not often able to become a monopsonistic buyer of that industry's raw materials. A great manufacturer of agricultural machinery cannot dominate the steel industry. For the same reason, large buyers usually cannot consolidate their power by explicit or tacit agreement. Neither organization nor identity of interest is available to coordinate the steel-buying policies of machinemakers, automobile manufacturers, and shipbuilders. Monopsonistic power can be easily acquired only in the purchase of highly specialized industrial equipment and of a few raw materials which have a specialized use. In such instances the buying power of

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to oil producers would be what the market would justify and not necessarily the price bid on the exchange. This agency purchased for Standard Oil Co. 80 per cent of the crude oil purchased in Pennsylvania, and through its position of transportation fixed the price of crude oil. This led to the posted price system we have today." See TNEC Monograph No. 39, *Control of the Petroleum Industry by Major Oil Companies*, pp. 24-25.

See also *United States v. American Petroleum Institute et al.*, complaint, Sept. 30, 1940, District of Columbia, par. 30, "The Pricing of Crude Oil," pp. 36-37.

a great enterprise usually reflects its position as a monopoly in the sale of the products made with the specialized materials and equipment.

But although monopsonistic power is relatively rare, large buyers can often buy more cheaply than their smaller rivals. This differential buying power appears whenever a buyer is big enough to become the sole outlet for a given seller[7] or to threaten to produce for himself[8] or to enjoy special opportunities to shift his purchases from market to market and from one period of time to another.[9] Even without monopsonistic control of the whole market, such special bargaining advantages are likely to be sufficient to obtain for the large buyer price concessions which are not available to his smaller competitors. Through these concessions the large buyer obtains an advantage in his subsequent operations as producer or distributor and thus enhances his size and power in the markets in which he sells. The chief problem created by the buying power of large concerns is not undue exploitation of sellers but rather the enhancement of disparities of size and concentrations of power at subsequent stages of the productive or distributive process.

THE POWER DERIVED FROM VERTICAL INTEGRATION

The second type of concentrated economic power is that of the vertically integrated enterprise. It has received relatively little attention

[7] For example, the Ford Motor Company has taken the entire output of some parts manufacturers and the major part of the output of many concerns. See Lawrence H. Seltzer, *A Financial History of the American Automobile Industry*, pp. 85-86, Houghton Mifflin Company, Boston, 1928.

[8] TNEC Monograph No. 41, *Price Discrimination in Steel*, contrasts the low prices paid by certain industrial enterprises—notably Ford Motor Company and International Harvester—with the higher prices paid by the Federal government. The Ford Motor Company's operation of its own steel works for a part of its supply is cited as relevant to this difference. The authors conclude that "This apparent inability of the Government to threaten the production of its own steel requirements has undoubtedly been of considerable importance in causing the Government to pay prices for steel usually acceptable only to the smallest and least effective private buyers." (Pp. 26-29.)

[9] The Great Atlantic and Pacific Tea Company, for example, maintains central buying offices throughout the country to search for and find sources of supply for the corporation's stores, furnish the corporation with market information, and purchase for it. See Federal Trade Commission Docket 3031, *In the Matter of the Great Atlantic and Pacific Tea Company, Findings of Fact and Conclusions of Law*, par. 5 (1938).

in discussions of public policy, although it is sometimes included in a broad definition of monopoly.

So long as the vertically integrated concern is self-contained, its occupancy of successive stages in the process of production and distribution does not accord it additional power beyond that which springs from its proportion of the market at a particular stage or from its aggregate size. But where such a concern has been disproportionately integrated, so that at one or more stages of production or distribution it acts as supplier or customer for enterprises with which it is in competition at other stages, the existence of vertical integration may become the basis for a special type of power. If a disproportionately integrated concern is big enough to be important to its competitors, it has the power to squeeze them. As a supplier of raw materials it may adopt a policy of high prices for materials and relatively low markups above these prices in its own sales of products that have been given further processing.[10] Thus it may reduce the operating margins of its customer-competitors by high prices for materials and low prices for finished products. As a purchaser it may follow the reverse policy, holding down the prices of raw materials which it both makes and buys and enhancing the operating margins which it enjoys in subsequent parts of the productive process.[11] Some power of this kind can be derived by a large vertically integrated concern from mere ability to juggle its profits between stages of production in which it is relatively strong and stages in which it is relatively weak. But this type of power is immeasurably increased if the integrated enterprise has a legal monopoly at any one of these stages. A public-utility franchise or a strong patent position may be used to exclude all competitors and to build an impregnable place as buyer or seller. Through vertical integration this strength may be made effective outside the field in which it is directly enjoyed. In particular, the power of a public utility may be extended from a service field in which the monopolist is subject to regulation into a field of

[10] See, for example, *Bausch Machine Tool Co. v. Aluminum Company of America*, 72 F. (2d) 236 (1934).

[11] *United States v. The New York Great Atlantic and Pacific Tea Company, Inc. et al.* [67 F. Supp. 626 (1946)] was based in part upon the charge that A & P had used its horizontal and vertical integration to obtain systematic discriminatory buying preferences from manufacturers, producers, processors, and suppliers. According to the government, the weight of its nation-wide purchasing power made its use of coercive pressure doubly effective. For a description of the practices, as charged, see *Brief for the United States*, filed Mar. 2, 1946, pp. 216-628.

equipment manufacture in which there are no corresponding checks upon the use of business power.[12]

THE POWER DERIVED FROM BIGNESS

The third type of concentrated economic power arises from giant over-all size. It has been the subject of reiterated popular agitation but has never been directly attacked by law and public policy.[13]

[12] See Federal Communications Commission, *Report of the Investigation of the Telephone Industry in the United States,* pursuant to Pub. Res. No. 8, 74th Congress, 1939. Included in the report is an account of the relationship between the American Telephone and Telegraph Co. and its subsidiary, the Western Electric Co. According to this account, the latter (unregulated) manufactures approximately 90 per cent of the telephone equipment produced in the United States. In addition it enjoys a monopolistic position in sales to the associated companies of the Bell System. Sales are made at noncompetitive prices (see pp. 316-323) and Western Electric profits have been extraordinarily high (pp. 544-566). The effect of the relationship on the rate structure for telephone service is described by the commission as follows: "Estimates of cost of reproduction of, or recorded investment in, telephone property for an individual State or exchange based on Western Electric costs or prices are entitled to little weight as evidence of the fair value of the telephone property involved as a result of the costing practices followed by Western Electric. . . . There is at present no satisfactory method of determining reasonable prices of telephone apparatus and equipment of Bell System companies as factors in establishing property values. Prices of telephone plants purchased from Western are not the result of arm's-length bargaining between unrestricted buyers and sellers. Western's cost accounting records do not provide dependable cost data on which to predicate elements of values. The Bell System's occupation of practically the entire telephone operating and manufacturing field precludes any control of Western Electric prices through competition, and any measure of the reasonableness of the prices by comparisons with other manufacturers. The importance of these conditions, from the standpoint of rate regulation, arises from the fact that a large part of the total investment in the Bell System, as well as a part of its operating expenses, is represented by the purchase price of telephone apparatus, equipment, and material. Consequently a large portion of the cost of telephone service depends directly upon unregulated prices which are subject to control by the American Co." (P. 587.)

[13] In his dissenting opinion in *Northern Securities Company v. United States,* 193 U.S. 197, Justice Holmes said about the Sherman Act: "There is a natural feeling that somehow or other the statute meant to strike at combinations great enough to cause just anxiety on the part of those who love their country more than money, while it viewed such little ones as I have supposed with just indifference. This notion, it may be said, somehow breathes from the pores of the act, although it seems to be contradicted in every way by the words in detail. And it has occurred to me that it might be that when a combination reached a certain size it might have attributed to it more of the character of a monopoly merely by virtue of its size than would be attributed to a smaller one. . . . The very words of the act make

Bigness gives power whether it is attained in one industry or in many. Great size is common to all giant enterprises whether their strength is based upon monopoly in a single large industry, upon vertical integration, or upon a conglomerate union of activities which are industrially unrelated. The significance of bigness alone is seen most readily in the case of the conglomerate enterprise, in which power due to size is not reinforced by power due to monopoly or to vertical integration.[14]

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such a distinction impossible in this case and it has not been attempted in express terms. . . . I am happy to know that only a minority of my brethren adopt an interpretation of the law which in my opinion would make eternal the *bellum omnium contra omnes* and disintegrate society so far as it could into individual atoms. If that were its intent I should regard calling such a law a regulation of commerce as a mere pretense. It would be an attempt to reconstruct society. I am not concerned with the wisdom of such an attempt, but I believe that Congress was not entrusted by the Constitution with the power to make it and I am deeply persuaded that it has not tried." (193 U.S. 407-411.)

[14] For example, E. I. Du Pont de Nemours & Company produces relatively few products of which its output constitutes as much as 50 per cent of the national supply. Yet, according to its *Annual Report* for 1946, its sales to customers for 1946 were $648,703,181. Additional manufacturing for the government and for affiliated concerns brought the over-all volume to approximately $782,276,000. Departments listed as sections of the company's over-all operations included the following: Ammonia Department (ammonia, urea, fertilizer compounds, methanol, higher alcohol, glycol, organic acids, hydrogenated products, antifreezes, and food chemicals); Electrochemicals Department (electro and industrial chemicals, including solvents for metal and dry cleaning and extraction, formaldehyde, cyanide, sodium, peroxide, ceramic colors, refrigerants, vinyl products, and fumigants); Explosives Department (commercial explosives, blasting accessories, and miscellaneous chemicals); American Glycerin Division (liquid and solidified nitroglycerin, oil and gas well torpedo service); Nitrocellulose and Sporting Powder Division (military and sporting powders); Fabrics Division (coated fabrics, washable window-shade fabrics, sheeted elastometers, impregnated fiber products, "Rug Anchor" underlay); Finishes Division (finishes for all industrial, transportation, marine, and household purposes, including lacquers, enamels, paints, varnishes, automotive waxes and polishes, solvents, nitrocellulose, plasticizers, and pyroxylin solutions); Grasselli Chemicals Department (inorganic and organic acids and heavy chemicals, zinc and zinc products, fungicides, seed disinfectants, household sprays and dusts, insecticides, animal remedies, weed killers, adhesives, wood preservatives, chemicals for textiles, water purification, paper, leather, steel and tool industries); Organic Chemicals Department (dyestuffs, tetraethyl lead, neoprene, ethyl alcohol, camphor, and other organic chemicals for the rubber, petroleum, textile, paper, and perfumery industries); Photo Products Department (motion-picture, X-ray, portrait, lithographic and micro films, fluorescent screens, photographic printing papers and processing chemicals); Pigments Department (titanium

The strength of the great concern is derived from the variety of tactics which it can use and the vast resources which it can command. Its aggregate assets are so great that it can take losses which would wreck smaller enterprises. Its operations are spread across so many customers, so many geographical markets, and, in the case of the conglomerate enterprise, so many different types of commodities and services that its fortunes do not depend upon profit or loss in a particular transaction, a particular location, or a particular activity. This diversity of interests not only immunizes it from the effects of business fluctuations which would mean disaster to an enterprise operating more narrowly, but also gives it the power to lose money deliberately at any one point for the sake of disciplining or destroying its more specialized rivals. In many cases this power of destruction is enhanced by the fact that the great enterprise becomes the supplier of transportation, distributive service, raw materials, technology, or some other productive resource which its smaller rivals find indispensable. With small enterprises at its mercy, the giant concern can deprive them of independent initiative and force them into a tacit vassalage. It can also destroy them up to the limits of prudence which are established by the watchfulness of the public authorities.[15]

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dioxide, lithapone, dry colors, and copperas); Plastics Department (polyvinyl butyral, polythene, cellulose nitrate and acetate plastics, nylon molding powder, and fabricated articles, such as combs and toothbrushes); Rayon Division (viscose rayon yarn, staple, and tire yarn); Acetate Division (acetate rayon yarn, commercial cellulose, acetate flake, and acetate staple); Cellophane Division (cellophane, cellulose caps and bands, cellulose sponges, cellulose acetate, and polyvinyl alcohol films); Nylon Division (nylon yarn, nylon staple, and nylon flake).

In addition to the above, the Company owned 22.7 per cent of the outstanding common stock of General Motors; 51 per cent of Kinetic Chemicals, Inc.; 50 per cent of the Celastic Corporation; 50 per cent of the Old Hickory Chemical Co.; 100 per cent of the Compañía Mexicana de Explosivos, S.A.; 66.67 per cent of the International Freighting Corporation; 60.17 per cent of the common stock and 99.25 per cent of the preferred stock of Remington Arms, Inc.; 57.36 per cent of Compañía Sud-Americana de Explosivos; 49.995 per cent of Industrias Químicas Argentinos "Duperial" S.A., which in turn owned 100 per cent of Industrias Químicas Uruguayas "Duperial" and 72.19 per cent of "Ducilo" S.A. Productora de Rayon; 49.96 per cent of Industrias Químicas Brasileiras, "Duperial" S.A.; and 41.76 per cent of Canadian Industries, Limited. Foreign distributing companies which were 100 per cent-owned included Du Pont (China), Inc., Du Pont Inter-America Chemical Company, Inc., Du Pont, S.A., Du Pont (Peru) S.A., pp. 38-42. Du Pont plants and controlled companies (exclusive of branch sales offices) were located in twenty-six states.

[15] See pp.157-179.

The great resources of the large enterprise also give it great power as a buyer of materials, energy, transportation, credit, and labor. It can search out the cheapest markets. It can obtain price concessions by concentrating its buying power, by timing its purchases, and by threatening to produce for itself. It can integrate vertically wherever suppliers are stubborn.[16]

Great size is also a source of special advantage in litigation, politics, public relations, and finance. The large concern has an advantage in the law courts because it can afford to use litigation systematically as a competitive weapon, not only where it stands to win the suits, but also where the costs and delays of litigation will embarrass its less powerful rivals.[17] It can acquire unusual influence in politics through personal contacts and campaign contributions and through unremitting

[16] For example, in the recent A & P antitrust case (cited above), the court declared: "Whether defendants would manufacture products in any instance was quite naturally based upon whether A & P could obtain such prices from suppliers as would make it imprudent, as a business proposition, to engage in manufacturing itself. As early as 1927, at the request of John Hartford for an expression on pushing A & P's own brands, the minutes recite that the time has arrived for making a 'demonstration in order to safeguard the arrangements which we now have with national manufacturers . . . national manufacturers . . . will be anxious to keep their arrangements with us attractive so that we would not consider it necessary to go into their lines. . . . Coffee would be the best commodity to start out with and White House milk next.'" (P. 638.)

[17] During the TNEC *Hearings* on Patents, Paul L. Geer, an official of the Amsler-Morton Co., producers of melting and annealing equipment for the glass industry, testified that his company was accused of patent infringement and was offered the "opportunity" of license. Upon rejection of the proposal, they were told: "Boys, we have made a good offer to you now. You can make a lot of money out of this. I will give you one month to consider it. If you don't go in with us . . . we will enter suit against you and will continue to sue you until you are out of business" and "It is our plan that nobody in the glass industry should own one piece of glass-making equipment." Geer further stated that after his company refused to reconsider its position, suit was begun in 1934 against one of its customers. Amsler-Morton was obligated by contract to defend the suit. The suit was still pending on appeal at the time of the hearing (December, 1938), and expenditures for defense had reached approximately $50,000. Partly because of fear of similar suits against other customers, purchases of the company's glass machinery had fallen from $800,000 in 1928 to $18,000 in 1939. TNEC *Hearings,* Part 2, Patents, pp. 596-602. See also statement of H. B. Cox, special assistant to the Attorney General, TNEC *Hearings,* Part 2, p. 444, and testimony of Thurman Arnold, Assistant Attorney General, *Hearings* before the Senate Patent Committee, 77th Congress, 2d Session, on S. 2303, April, 1942, pp. 639-640.

attention to the detail of all political matters which affect it.[18] It can do much to manufacture its own reputation by large expenditures for direct and indirect advertising under the guidance of public relations counsel.[19] It can attain a substantial degree of control over the sources of credit, for through affiliation with one or more great commercial banks it may have preferential access to funds and be protected against the calling of its loans when credit is overextended or its own position has become precarious; and through affiliation with one or more great investment banks it may command sympathetic underwriting service.[20] Such financial affiliations may also be useful in imposing a handicap upon inconvenient rivals; for the affiliated bank is unlikely to extend or continue loans to competitors whose market policies are regarded

[18] For example, the American Smelting and Refining Company, the Pacific Gas and Electric Company, and the Arabian-American Oil Co., among many others, maintain staffs or retain legal firms to look after their interests in Washington. See Congressional Record, Feb. 5, 1947, pp. 863-884.

[19] In three years, 1939-1941, the Great Atlantic & Pacific Tea Company spent more than 1½ million dollars to convince consumers and legislatures that chain stores are desirable. According to the Department of Justice, much of this money was spent to support supposedly independent organizations of consumers and farmers and to supply news releases to labor publications through supposedly independent channels. See *United States v. The New York Great Atlantic & Pacific Tea Company, Inc. et al.*, Brief for the United States filed Mar. 2, 1946, pp. 1045-1073.

[20] In 1913 the House of Representatives committee investigating the concentration of control of money and credit concluded that "Far more dangerous than all that has happened to us in the past in the way of elimination of competition in industry is the control of credit through the domination of these groups [the money trust] over our banks and industries. It means that there can be no hope of revived competition and no new ventures on a scale commensurate with the needs of modern commerce or that could live against existing combinations, without the consent of those who dominate these sources of credit. A banking house that has organized a great industrial or railway combination or that has offered its securities to the public, is represented on the board of directors and acts as its fiscal agent, thereby assumes a certain guardianship over that corporation. In the ratio in which that corporation succeeds or fails the prestige of the banking house and its capacity for absorbing and distributing future issues of securities is affected. If competition is threatened it is manifestly the duty of the bankers from their point of view of the protection of the stock holders, as distinguished from the standpoint of the public, to prevent it if possible. If they control the sources of credit they can furnish that protection. It is this element in the situation that unless checked is likely to do more to prevent the restoration of competition than all other conditions combined." *Report of the Committee to Investigate the Concentration of Control of Money and Credit,* HR., 62d Congress, 3d Session, *Report* No. 1593, 1913, pp. 159-160.

as dangerous to the large enterprise,[21] and the affiliated investment bank is unlikely to encourage security flotations by such rivals. Although the crudest forms of discrimination by credit institutions can be prevented by public regulatory processes, subtler devices are difficult if not impossible to prevent. The decisive significance of such relationships is manifest in this country in the fact that some of our most powerful industrial communities of interest have been built up around some of our greatest commercial and investment banks.[22] It is even more evident in Japan,[23] where the dominant influence that the four largest corporate combinations attained over the Japanese economy was derived in large part through their control of banking and their use of financial favoritism to acquire control of industry.

Like the complex monopoly, the large conglomerate enterprise may sometimes be induced by the complexity and diversity of its own operations and by the desirability of internal consistency in its own policies to forego the full use of its power at all points. Moderation in the use of power is likely to be encouraged by the fact that the giant enterprise, being conspicuous, is exposed, in spite of its expenditures on public relations, to political and legal attack if its conduct runs counter to the beliefs and interests of the community. Moreover, the management of large enterprises often requires imagination and intellectual capacity of a type seldom associated with the pursuit of petty advantage. But although through such influences power may be used more considerately, it continues to exist and to be employed in the service

[21] Withdrawal of bank credit from rivals was one means used by large meat packers to acquire competing companies. See Federal Trade Commission, *Report on Agricultural Income Inquiry,* Part I, p. 201.

[22] The Department of Justice has stated that "Practically every important industry shows the effect of the investment banker's inclination to merge and combine competing companies. Probably the most outstanding historical example of such a combination was the formation of the United States Steel Corp. at the beginning of the century." *Staff Report to the Monopoly Subcommittee of the Committee on Small Business,* Pursuant to H. Res. 64, 79th Congress, Dec. 27, 1946, p. 239.

See also the National Resources Committee Report, *The Structure of the American Economy,* 1939, Part I, Basic Characteristics. The Committee reports that "The formal interrelationships between the larger corporations brought about through interlocking directorates can be seen by examining the directorates of the 200 largest non-financial corporations and the 50 largest financial corporations . . ." (p. 158). For a description of such interlocking directorates, see Appendix 12, pp. 298-305.

[23] See U.S. Department of State, *Report of the Mission on Japanese Combines,* March, 1946, Part I, Analytical and Technical Data, Chap. 3, "Financial Institutions and the Zaibatsu."

of the enterprise that possesses it. No amount of business statesmanship on the part of those who control great corporate estates can eliminate recurrent conflicts of interest between these corporations and other economic groups; and where such conflicts appear, the power of the great corporations protects their interests.

By use of the types of power that have been described above, a giant enterprise can sap the vigor and attenuate the usefulness of competition. Its coercive control may make its smaller rivals act as though they were parties to a collusive understanding, and may limit these rivals so greatly in number and size that they consist merely of a few residual enterprises providing a token competition. The power of the great concern may create difficulties for new competitors who wish to enter its fields of activity. The importance of the great concern is such that it causes capital markets and service facilities to be organized along lines appropriate to large transactions. In the flotation of new securities, for example, appropriate channels are available for placing large issues but not for placing small ones, and small enterprises thus find themselves at a disadvantage because they do not fit existing market institutions.[24] Finally, large enterprises are often unwilling to engage in vigorous rivalry with one another. They meet one another at so many points that it would often be difficult for them to compete in one industry without upsetting the precarious balance of their interests in

[24] In TNEC Monograph No. 17, *Problems of Small Business,* the authors point out that "The economic and financial position of the small businessman is further weakened by the cost involved in obtaining capital." They cite the SEC record of 217 stock and bond issues registered in 1937 and compute the cost of security flotation of common stock issues of less than $250,000 at 22 per cent as compared with 16 per cent expense in issues of over $1,000,000. The cost differential in preferred stock and bond issues is described as even "more marked." The SEC survey of sales by small companies (*Selected Statistics on Securities and on Exchange Markets,* Government Printing Office, Washington, D.C., August, 1939, p. 35) is quoted to the effect that registered security sales by such concerns are exceedingly difficult (as contrasted with comparable sales of large issues by large concerns), and that "of the $321,000,000 of securities registered by the 584 registrants, only $74,000,000, or 23 per cent, was sold within a period of about one year following the date of registration." (P. 219.) The authors conclude that "The evidence from the SEC registrations already mentioned is concrete illustration of the fact that the capital markets are simply not organized for small issues, and consequently closed to small businesses." (P. 227.) And again, "One reason for the inability of small business to obtain equity capital lies in the fact that it does not have the same access to the capital markets as does large business, since that machinery is adapted largely to the needs of big business." (P. 261.)

other industries, and in such cases the costs and risks of warfare with another giant are likely to be too great to be justified by a temporary competitive advantage at a single point. Hence large enterprises are likely to form comprehensive alliances across many industries [25] and to show great forbearance toward one another even where formal alliance has not yet been consummated.

Thus bigness may destroy competitors, eliminate competitive initiative, and lead to the adoption of restrictive policies even where the big enterprise is a conglomerate concern without monopolistic power in particular markets. Moreover, such competition as remains is likely to be deprived of a large part of its social usefulness, for the tactics of competition by or against a giant enterprise do not consist merely in simple efforts to produce efficiently and sell cheaply but are likely to emphasize maneuvers, such as have been described above, for advantage in the law courts, in politics, in credit manipulation, in making business alliances, and in playing off one market against another. Since the policy of the great enterprise in any one market is likely to be an incident in a broad strategy of power, without much regard to immediate considerations of profit or loss, such a concern may limit profitable sales or raise prices in order to preserve the good will of a powerful ally,[26] may extend the production of goods, whether profit-

[25] For example, Du Pont and Imperial Chemical Industries have used patent rights and licensing agreements to allocate territory between them for twenty or more different classes of product. With exceptions for certain special products, Du Pont is granted exclusive rights in the United States and Central America and ICI has exclusive rights throughout the British Empire with the exception of Canada. In Canada, Argentina, and Brazil the companies have agreed to exploit the market through jointly owned subsidiaries: Duperial in Argentina; Canadian Industries, Limited, in Canada; and Duperial in Brazil. See Edwards, *op. cit.*

[26] In 1937 a Du Pont executive wrote to a representative of his company in Brazil: "At times we have occasion for discussions with certain of our competitors as relating to matters of mutual interest in various foreign markets, and during one of these talks it was brought out that our company is supposedly making sales of certain dyestuffs to Brazilian consumers at prices which are considerably below the returns secured by other manufacturers. Certain specific items mentioned were Auromoine Conc., Rhodamine B Extra and Saframine; in all of these cases our selling prices being supposedly upward of 50 per cent lower than quotations made by the Europeans.

"We do not know how accurate this report really is but it seemed worth while for us to bring it specifically to your attention in as much as you are thoroughly familiar with our company's policy to establish selling prices which are in line with those already in effect. If by chance there should exist any such wide discrepancy as

able or not, in order to preempt a market,[27] or may reduce a price unprofitably in order to weaken a competitor.[28] Thus bigness reduces the effectiveness of price comparisons and of possibilities of immediate profit or loss as guides to productive activity.

Some of the advantages of large size may be attained on a local scale. A concern may be a large producer or consumer within a limited area and may thus enjoy a local strength which grows with each increase in the cost and difficulty of access to its more distant competitors. Moreover, a substantial enterprise in a small community may overshadow local government, dominate the local labor market and local credit institutions, and be the principal source of income for those who sell to its work force. It may thus attain broad political and economic power within the community in a way that is loosely comparable to the effect of a much larger enterprise upon the national scene.

No attention will be given in this discussion to such localized examples of monopoly power. Their effectiveness is measured by the importance of the obstacles of distance, inconvenience, ignorance, and trade-barrier legislation which separate the local community from others more distant. Reduction of these obstacles by removal of various types of public and private trade barriers is an important part of competitive policy and will be discussed as one aspect of the problem of access to markets. It is hopeless, however, to try to destroy inherent advantages of location or to prevent these from conveying some modi-

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was reported, we want to take immediate steps to rectify the situation. . . ." See *ibid.*, pp. 14-15.

27 In 1940 an official of Imperial Chemical Industries wrote to another company: ". . . We should like to make clear that our object, when we considered the manufacture of soda ash in Brazil, was primarily to control or preserve our present joint control of the market and to safeguard your, as well as our future import business. It was for this reason that we intended to limit the size of the projected plant to 20,000 tons." (*Ibid.*, p. 47.)

28 Shortly before the recent war the manager of Duperial of Argentina wrote: "From the beginning we have felt that our policy opposite Bunge & Born should be fixed, having regard more to future than our immediate profits. If we do not accept Mr. Hirsch's demands, we shall have to face a period of unsatisfactory earnings on our acid, but in the meantime we shall be making the chemical business most unattractive to Bunge & Born and this, in time, can only have the effect of removing all enthusiasm for their making further investments in our field. By sticking to this policy, the logical outcome will be a general arrangement with B. & B.—maybe one or two years hence—but under conditions which must be distinctly more favorable to us than if we were to reach agreement today on the terms Mr. Hirsch wishes to impose upon us." (*Ibid.*, p. 48.)

cum of monopoly power. So long as this power can be neither pyramided nor consolidated, its existence may be regarded as consistent with competition.

THE SCOPE OF A POLICY ABOUT EXCESSIVE CONCENTRATION

Prevention of excessive size in business units is an indispensable part of a competitive policy. It is needed both as a safeguard against restrictive agreements and as a means to prevent the adoption of restrictive policies based upon the power of single concerns without agreement. It is needed to maintain a sufficient number of competitive alternatives to preserve the protective functions of competition. It is needed to keep competitive tactics intimately related to productive and marketing processes, as distinguished from broad maneuvers for power which have little functional significance.

However, considerations of efficiency and economy must be appraised in determining what degree of size is excessive. Business must be permitted to grow large enough to be efficient. In applying the competitive policy to big business, we must not only identify excessive accumulations of business power but also determine the scope of the toleration which should be accorded to large business enterprises for efficiency's sake. If big enterprises improve technology, stimulate research, assure better management, stabilize industrial operations, or otherwise serve the public interest, these advantages should be preserved so far as their preservation can be made consistent with the competitive policy; and if at any point choice must be made between effective competition and any of these advantages, the decision should follow a careful weighing of the pros and cons.

Much of the research that should support policy decisions of this type has not been done. We know enough about the size and growth of large enterprises to be sure that their relation to competition is crucial to the success of the competitive policy; and in particular instances we know enough about the power they have and the way they have used it to demonstrate that it must not be left unchecked. Nevertheless, definitive and comprehensive information is not available on a scale sufficient to show the structure and relationships of our large corporations, the focal points of their power, the relative prevalence of their various policies and practices, and the impact of these policies and practices upon the commonwealth. Illustrative cases are not

enough in planning a campaign against excessive concentration of power.

Information about the nature and extent of the contribution made by bigness to the prosperity of our economy is even scantier. There is much self-serving assertion from large corporations, but little dispassionate analysis and even less evidence. Our concept of efficiency has been developed in a form suited to a manufacturer producing a single homogeneous product, and is not wholly appropriate to an enterprise that produces differentiated lines of products. There are great gaps in our knowledge about the extent to which increase in the size of the business unit has helped or hindered improvement of the large concern's technology, extension of its research activities, reduction of its unit costs, regularization of its employment, and fuller use of its productive capacity. No systematic effort has been made to distinguish between functional improvements in the large concern that are achieved by imposing higher costs upon other enterprises and functional improvements that make a net contribution to the effectiveness of the economy as a whole. Little is known as to whether any functional improvements which may have accompanied industrial concentration could be held or extended while reducing the size of the business unit.

With the pros and cons of big business inadequately known, there is a strong temptation to limit recommendations about the concentration of economic power to proposals that ambitious research be undertaken and that little else be done until the results of the research are available.[29] Unfortunately, what is known about the problem indicates that such delay would be unduly dangerous. Our large enterprises are growing by accretion, and their power appears to show an increasing momentum. There is a substantial risk that, before the diagnosis of big business is completed, the independence of small enterprise will have been destroyed and the time for effective remedial action will have passed. Indeed, some observers of the American business system assert that already the competitive policy has ceased to be practicable.[30]

Accordingly, though research into the problems of bigness should be

[29] *Cf.* Estes Kefauver, "Needed Changes in Legislation," speech delivered before the American Economic Association, Chicago, Ill., Dec. 30, 1947.

[30] *Cf.* Ben W. Lewis, discussion of papers on enforcement of antitrust laws before the American Economic Association, *Papers and Proceedings of the Sixtieth Annual Meeting of the American Economic Association,* American Economic Review, Supplement, May, 1948, pp. 211-214.

promptly undertaken on an ambitious scale, a tentative policy of attack is needed even before the research is completed. The policy should be improved from time to time as better information becomes available; but meanwhile inadequate knowledge should not become a reason for accepting defeat.

Such a tentative policy is set forth in the pages that follow. In discussing the extent of the conflict between competition and efficiency and the standards that should be used in identifying monopoly power, harmful vertical integration and harmful giant size, the writer does not profess to have found definitive solutions for these difficult problems. But the risks of a policy such as is here suggested are thought to be less than those of inaction or of the insufficient policy that now prevails; and it is believed that if the standards proposed herein are applied where the danger from undue concentration of power is most evident, experience will provide a basis for improvements of policy in subsequently dealing with more controversial cases.

MONOPOLY AND EFFICIENCY IN THE ONE-PLANT ENTERPRISE

The extent of the conflict between the competitive policy and the maintenance of a scale of business activity suited to efficient operation is probably less than is often supposed. In discussing the relation between efficiency and bigness, two types of size must be distinguished. The first and simplest is the big establishment that produces large quantities of goods under a single roof. The second is the big business unit that is centrally directed but operates several separate establishments. This large business unit may take several forms. It may be a single corporation and thus constitute a legal unit for purposes of management and financial computation. It may be a big combine that unites several corporations under a single control and directs them in accord with a central policy. It may be a big community of interest that unites various business activities—severally carried on by persons, corporations, or combines—under a common but informal control, or expresses a unity of policy in a continuous cooperation between businessmen who are closely associated with one another. Whatever the form of the control, such a business unit is under a central control but is not technologically centralized.

Though an enterprise may be called large either because of the size of a single plant or because it operates many plants, there is no com-

mon likelihood that bigness will produce efficiency in these two cases. An analysis appropriate to the large establishment would be irrelevant to the large business unit operating several plants.

The case for preserving the large industrial establishment on grounds of efficiency is overwhelming. Specialization, mechanization, uniformity of processes, interchangeability of parts, and scientific control of the accuracy of results—such sources of economy in modern manufacture have developed primarily in large technological units and may be expected to continue to do so. Although progress in the techniques of mass production often permits large plants to be replaced by smaller plants which produce specialized parts for assembly at central points, this form of organization typically appears after new processes are well understood, not while they are being developed. Pioneering in mass production is carried on in the big factory.

Acceptance of the large establishment raises few problems for the competitive policy. Neither industrial monopoly nor industrial gianthood is common among such one-plant concerns.

Nevertheless, there are some commodities that have a national market so small that one or two plants may meet the needs of the whole country; and there are other commodities that are so bulky or so perishable that they must be sold in relatively isolated local markets which can be supplied from one or two local plants. Products of the first type include certain specialized forms of industrial equipment which are used in limited quantities and certain simple and relatively unimportant consumers' goods, such as wooden toothpicks. Products of the second type include such perishable commodities as ice and such bulky, unstandardized commodities as millwork. In cases such as these the technological advantages of large-scale production may establish single-plant monopolies.

Monopolies of this type are not likely to be powerful or important. A one-plant monopoly is a relatively small enterprise. If the monopoly is local, the limits of its control are set by the costs of purchasing from more distant concerns. If the monopoly is nationwide, it is usually exposed to competition from substitute products which, as technology becomes more dynamic, are likely to be increasingly satisfactory. Moreover, if any portion of the supply of the monopolized product is still made by competing concerns, these competitors may well be as large in over-all size as the monopolist, and, being dependent for their business success primarily upon other markets, are likely to determine their competitive policies with substantial independence. When restrictive

policies of the monopolist make the monopolized field highly profitable, competitors of this type are likely to increase their sales there quickly and decisively. Hence, even when their share of the market is small, they may afford the buyer adequate alternative choices. Moreover, the single-plant monopoly is often exposed to potential competition from enterprises that are as large as, or larger than, itself. Because of such limitations upon its power, a small concern may control a large proportion of the total sales or purchases of some commodity without deriving from that fact much power to follow a restrictive policy in the market or to coerce its competitors.[31]

Nevertheless, there are a few cases in which large plants may become the source of significant monopoly power. Certain commodities with a limited national demand may be strategic or irreplaceable and not readily produced by new enterprises. Certain important basic materials are limited in supply and subject to mass production, so that a few large plants occupy the whole market. This condition prevailed in the aluminum industry before the recent war. Under such circumstances, competition would be difficult to maintain even if every plant were a separate enterprise. In 1939, for example, the nation's supply of alumina came from only one plant,[32] and its domestic supply of virgin aluminum from only four.[33] Though such cases are relatively few, they are too important to be ignored. In varying degrees they present contradictions between the requisites of efficiency and the requisites of effective competition. They may make necessary a choice among three courses of action: preserving competition and accepting some impairment of efficiency; preserving efficiency and accepting some

[31] Economic theory has been traditionally concerned with analysis of the effects of a monopoly of a single product and has emphasized the growth in ability to raise prices by restricting output which comes with an increase in the proportion of the total output which is under a single control. Although the significance of potential competition and of the competition of substitutes has been admitted, and the implication that monopoly power increases as more products are monopolized has been recognized, these points have been treated as qualifications, while the attention of theorists has been focused upon single markets. The contention here is that the classical case of monopoly is relatively unimportant and that the significance of the monopoly problem is to be found primarily in phenomena that lie outside the central focus of the traditional theory.

[32] Report of the Surplus Property Board to Congress, *Aluminum Plants and Facilities,* Sept. 21, 1945, p. 17. The plant was located in East St. Louis, Ill.

[33] Pig aluminum was produced at Alcoa reduction plants located at Niagara Falls and Massena, N.Y.; Badin, N.C.; and Alcoa, Tenn.

significant degree of monopoly power; or providing a system of public regulation in which efficiency is preserved under safeguards substituted for those of the competitive policy.

But even where one of the two latter courses is adopted, the competitive policy should not be entirely abandoned. Opportunities for new concerns to enter the industry and for substitute products to be developed should be kept open. Technological monopolies should be prevented from consolidating their power by coercive and preclusive tactics and should be denied the support of governmental trade-barrier legislation. The power of such monopolies should be made more precarious by governmental support for research designed to develop substitute commodities and technologies. Through such policies, as much as possible of the ordinary competitive safeguards should be preserved.

In so far as the requisites for industrial efficiency are merely technological, the utmost concentration of economic power that would be necessary in a policy based upon efficiency can be roughly estimated from the size of the plants now controlled by our large corporations. In the case of the United States Steel Corporation, for example, technological considerations would prevent efforts to break up the individual mills at Gary, Pittsburgh, and Birmingham, and probably would also require maintenance of central authority over the entire works located at any one of these three places. But such considerations would not require that all three of these geographically separate establishments remain under a single control. Obviously, if business concentration were brought down to a scale appropriate to modern technology, our large business units would be much smaller than they are today, and many of our monopoly problems would be reduced or ended.

BIGNESS AND EFFICIENCY IN MULTIPLE-PLANT ENTERPRISES

The case for preserving the large business unit that contains more than one establishment is less persuasive than that for preserving the large plant. It rests upon alleged efficiencies of management rather than of technology. Unitary control over big business units is alleged to be economical even where the units include many separate establishments. The degree of truth in this argument is crucial in determining the extent of the necessary conflict between policies of maintaining competition and encouraging efficiency.

Unfortunately, the arguments both for and against the efficiency of central business management are ill supported by verified evidence and are often stated in vague terms. The present discussion must rest upon such information and argument as has become available.

The heart of the argument for the efficiency of a large enterprise that is not a technological unit is that there are economies in centralized management. Where the large concern operates within a single industry, concentration of related products in the same plant is said to reduce operating costs, or supply of each customer from the nearest plant is said to reduce transportation costs. Elimination of duplicate officials, services, and systems of records is said to make unitary control over several establishments cheaper than separate control over each. It is argued that bigger businesses can afford to provide statistics, technological research, and other services that would be ruinously expensive for a small business; that bigger concerns can afford to hire more competent managers; and that the large enterprises can obtain cheaper credit than the small ones.[34] The diversification of large enterprises is said to promote their stability by spreading their business risks over various markets and products, some of which are likely to yield profits when others yield losses.

Such arguments are properly subject to a substantial discount. Some of the alleged economies are inconsistent with one another, so that a concern may conceivably enjoy either but not both. This is true, for example, of plant specialization on the one hand and service to each customer from the nearest plant on the other. Other alleged economies reflect advantages of bargaining power, which, however profitable they may be for the particular concern, do not benefit the community at large. This is true, for example, of most of the advantage that the large concerns enjoy in obtaining credit, for this advantage consists primarily of special alliances with credit institutions and of a pervasive influence by virtue of which the channels of credit have been organized to serve large enterprises rather than small ones.

A further discount of these alleged advantages must be made for

[34] For a listing of some of the alleged advantages, see H. W. Laidler, *Concentration in American Industry*, pp. 446-468, The Thomas Y. Crowell Company, New York, 1931.

For analysis of the economies associated with monopolistic combinations, see Eliot Jones, *The Trust Problem in the United States*, pp. 499-541, The Macmillan Company, New York, 1927 (copyright by Eliot Jones). Much of his argument is applicable to large corporations as well as to combinations of legally separate enterprises.

some of the offsetting disadvantages which are alleged to be characteristic of large concerns.[35] One of these is inflexibility—the difficulty that any far-flung enterprise experiences in adjusting itself to varying circumstances. Another is red tape—the tendency to avoid incoherence and confusion by excessively rigid rules and meticulous observance of hierarchical lines of authority. A third is internal conflict—the tendency of members of a large organization to intrigue against one another for power by devices that partially thwart each in the performance of his assigned duties.

How much is left of the alleged economies of central management after such discounts have been made is problematical. Doubtless there is variation from case to case according to the techniques and skill of each management. For present purposes it is sufficient to presume that some large units represent some gain in efficiency, though less than is alleged on their behalf.

However, such a presumption is reasonable only where there is an active central control which concerns itself with the direction of the physical processes of production and distribution. There can be no central-office economies if there is no central-office management. Where the activity of the central office is devoted to enlarging the bargaining power of the concern, there is often little centralized industrial control. In these cases, central-office functions are likely to be limited to such matters as pricing, litigation, lobbying, and maintenance of satisfactory public relations. However advantageous the enterprise may find such projects, there is no public advantage in private accretions of power for such purposes. Hence there need be no hesitancy in dissolving business units which have centralized their bargaining

[35] Professor Eliot Jones described the situation as follows: All large businesses and trusts in particular are likely to be burdened with the problem of centralized administrative machinery. Where plants are separated over wide areas, personal and close supervision by executives is impossible. It becomes necessary then to set up an elaborate system of records and reports as control devices. Desire for standardization, combined with aversion to change, may well tend toward routine treatment of materials received and inefficient use of them. Subofficials in the field tend to lose their initiative and enthusiasm because of the red tape involved in reviewing their suggestions and recommendations. "What is gained at the center in the way of control and guidance may thus be lost through reduced efficiency and energy at the circumference." He concludes that horizontal control on a large scale has inherent disadvantages which are further magnified as the "competitive spur" is diminished. See Jones, *op. cit.*, pp. 538-539. See also TNEC Monograph No. 11, *Bureaucracy and Trusteeship in Large Corporations.*

power rather than their management, nor in scaling down the size of business units in which centralization of bargaining power has outrun centralization of management.[36]

A second type of argument for the efficiency of the large corporation asserts that there is no substitute for the skill of a smoothly coordinated organization of managers and minor executives in formulating and organizing a business project and assuring the efficiency of its execution. From this point of view, business organization itself, with the many skills and techniques which it comprises, is the basic technological asset, whereas machines, plants, products, and even central-office functions are merely the material with which a given organization is working at a given time. On behalf of this view, it is urged that the great American corporations recently set aside their machinery, their products, and their markets for the duration of the war, and in an amazingly short time accomplished unprecedented results in producing war materials with which they and other members of the business community were wholly unfamiliar. It is implied, if not directly asserted, that capacity to plan and to make such adjustments is peculiar to the large corporate organization.[37]

This is an arresting argument and, in its emphasis upon skills as distinguished from machines, a persuasive one. However, success in conversion to war production has been frequent in the case of small enterprises as well as large ones, and the idea that the plants of the great corporations could not have been successfully converted but for central planning made possible by their concentrated control by central managements rests upon mere assertion. It is obvious that government agencies responsible for war production preferred to negotiate with

[36] Many large corporations are formed by mergers which leave existing managements substantially intact. For example, according to *Time* for Aug. 5, 1946, ten textile fabric manufacturers undertook during that month to combine their 28 mills in a single company under an arrangement by which existing managements would operate as divisions of the consolidated enterprise. The principal advantage was said to be the union of rayon, cotton, and woolen manufacture as a hedge against collapse in the market for any one of the fabrics.

[37] See Peter Drucker, *The Concept of the Corporation*, pp. 20-83; 209-229, The John Day Company, New York, 1946. In a letter to the writer, Mr. Drucker states: "My point was that what big business possesses is not a physical superiority but a managerial superiority. The physical job of production could in many cases be done fully as well in a small unit. The managerial, intellectual and theoretical job of planning for this production, of integrating and coordinating it, could not, I maintain, have been done without the leadership and the experience of big business management."

large enterprises, but this choice was largely due to a desire to save their own time by making fewer decisions and to the fact that the officials of these agencies, having been borrowed from big corporations, were often personally acquainted with the executives of the larger concerns. The actual processes of wartime conversion, solution of the operating problems involved, and in many cases even the planning and development of the conversion projects, were left by great enterprises to plant managers or division managers. Though the argument that large size is necessary to skill in project development is subtle and hard to appraise, it is probably untrue.

It is noteworthy, too, that the efficiency of the large corporation is sometimes asserted on the ground that great size can be made consistent with the maintenance of competitive incentives. Competition within the concern between working teams, plant managers, and even industrial laboratories is regarded as necessary to corporate growth.[38] To the extent that such relationships prevail, the superior efficiency of competition over central direction is recognized, and thus one of the principal arguments for bigness is abandoned. It is sometimes asserted, however, that such intracorporate competition gives better results than competition between separate business units, because in the former, unlike the latter, advantages based upon historical accident can be discounted and accurate measurement of competitive results can be provided.[39] But though such rivalry may be effective as a means of inducing hard work and identifying ability, it serves merely to intensify the performance of the participants along lines prescribed by the corporation. In a concern that has chosen to raise prices, restrict output, avoid improvements in the product, or limit new investment, internal competition does nothing to overthrow these decisions. Certain types of business costs may be reduced, but safeguards for the public interest are not provided.

Another argument that is sometimes made for a business unit large enough to include several producing establishments is that the size required for efficient marketing may be greater than that required for efficient distribution. It is peculiarly difficult to appraise this conten-

[38] According to a former director, the great German chemical combine, I. G. Farbenindustrie, kept its research decentralized in a number of separate laboratories in order to assure competition among its scientists.

[39] See J. W. Jenks, "Trusts and Industrial Combinations," *Bulletin* of the Department of Labor, Vol. V, No. 29, p. 675.

tion. The community has an interest in preserving the efficiency of the portion of the marketing process that consists of functionally necessary distributive activities. However, a considerable part of marketing consists in efforts to enhance the bargaining power of one enterprise as compared with another, or to strengthen the position of the seller as compared with the buyer. Greater efficiency on the part of one concern in its efforts to take business from its rivals may be offset and rendered meaningless by greater efficiency on the part of the other concerns in protecting themselves; and enhancement of bargaining strength may have no such social usefulness as to call for a public policy designed to preserve it. Since the functional and bargaining aspects of marketing are intimately intermingled, the concept of socially desirable efficiency in marketing is difficult to formulate and apply.

Moreover, the argument that need for a large marketing unit justifies control of several producing establishments rests upon the dubious assumption that efficiency is enhanced if producing and distributing organizations are under the same ownership and control. In some industries the large distributor buys supplies from various small producers, and large-scale marketing is thus reconciled with small-scale manufacture. Through appropriate purchases the distributor may obtain both a large amount of goods and a stock more diversified than the product of any single manufacturer. Only where the efficiency of vertical integration is greater than that of such coordination through the market can there be any need to preserve the multiple-plant enterprise for the sake of efficient marketing.

The uncertain and qualified nature of these various arguments on behalf of the efficiency of the big corporation stands in sharp contrast to the unambiguous character of the bargaining advantages which are attained by bigness. To create a large corporation may be to gain something in central-office economies, in marketing efficiency, or in organizational skill. It is certainly to gain much in control over customers, coercive power over competitors, preferential status before banks and other service organizations, and ability to turn law and politics to business advantage. The bargaining advantages of bigness are sufficiently great and obvious to account for the existence of large enterprises, apart from any economies which these concerns may achieve. Since these advantages tend to grow with each increase in size, whereas there is no reason to believe that the economies of size show a similar continuous growth, it is probable that the scale of big-

business organization has outgrown any which can be justified on grounds of efficiency.[40]

The foregoing analysis, applicable to large multiplant corporations, is even more persuasive in the case of the large corporate combine or the loosely knit community of interest. Neither of these types of bigness is likely to provide central management to the same degree as a large corporation. Productive and distributive activities in such business units are usually controlled separately by the managements of the various legal entities which have been combined. The top officials who hold the organization together are engaged not in producing goods but in manipulating power. To break up a great combination by severing the ties between the corporations that compose it would ordinarily require little or no change in the management of its physical activities, but would reduce the bargaining power of each of the severed parts. To break the more tenuous connections which hold a loose community of interest together would usually have even less effect upon efficiency.

In the light of this analysis, much can be done to reduce the size of the larger American business units without danger that the public advantages derived from bigness will be thereby destroyed. Wherever

[40] No satisfactory evidence is available to test this hypothesis. Available information about the costs of enterprises of different sizes is too scattered and its comparability too uncertain, to justify conclusions about relative efficiency. For an effort to make use of cost comparisons, see TNEC Monograph No. 13, *Relative Efficiency of Large, Medium-sized, and Small Business,* prepared by the Federal Trade Commission, pp. 13 and 72*ff.*

Comparisons of rates of profit in corporations of different sizes are more readily available; but they do not measure relative efficiency, since the rate of profit is affected by bargaining advantages and various other factors as well as by efficiency of operation. Since bargaining advantage tends to grow with size, a corresponding increase of profits might be attributable to corporate power, whereas a failure of profits to increase, too, might be a persuasive indication that the level of efficient operation had been passed. Available studies reach conflicting conclusions as to the relation of size to rate of profit. In *Corporate Size and Earning Power,* Harvard University Press, Cambridge, Mass., 1939, William Leonard Crum found that "the rate of return advances with increasing size rapidly in the low size classes and persistently in the higher classes" (p. 230) and that "with some but probably not numerous exceptions, a decrease of relative variability in rate of return with increasing size is characteristic of corporate experience in 1936." (P. 334.) In *Industrial Profits in the United States* (National Bureau of Economic Research, New York, 1934), Ralph Epstein found that in 1924 and 1928 the rate of return upon capital fell as the size of the concern increased. From scattered information the Federal Trade Commission concluded (*op. cit.*) that the highest rate of profit appeared more often in medium-sized than in large enterprises.

the functions of central management consist merely of activities to enhance the bargaining advantages of the enterprise, the scale of operation can be reduced without fear of reducing efficiency. Even where managerial economies have resulted from central control, some reduction in size will often be possible without sacrifice of these economies. Moreover, some activities that are performed centrally in a large business unit are capable of being continued as cooperative undertakings among smaller business units or as services sold to the business community for fees. This is notably true of industrial and economic research and the provision of engineering, accounting, and legal services.

Nevertheless, any broad program to break up concentrations of economic power would unquestionably reveal conflicts between competition and efficiency. These would arise wherever the scale of operation requisite for administrative economies is so large that the concern which achieves it enjoys monopoly power in an industry or acquires excessive bargaining power because of its aggregate size. It is impossible to forecast the scope of such conflicts, but it is apparent that many business units could be substantially reduced in size before the conflicts appeared and that, even if every plausible claim to preserve bigness on grounds of efficiency should be granted, the concentration of economic power would be decidedly less than it is now. It is probable that without impairment of efficiency we could end many of our industrial monopolies and greatly reduce the power of our conglomerate business giants.

THE IMPRACTICABILITY OF RIGID LIMITS UPON PERMISSIBLE SIZE

The effort to keep enterprises relatively numerous and small would be greatly simplified if one could fix an arbitrary and uniform ceiling for the size of the business unit. Suggestions are occasionally made that no enterprise should be permitted to attain more than a stated maximum size as measured by assets or employment and that within a single industry the largest concern should not be permitted to exceed a stated percentage of the industry's total sales, production, or productive capacity.[41] Unfortunately, ceilings such as these are not practicable. The significance of a given absolute size differs from case to case with

[41] Such a principle is invoked in a law for the deconcentration of industry, adopted in February, 1947, in the American and British zones in Germany. The law provides that employment of more than 10,000 persons shall be regarded as prima facie

variations in technology, in methods of economic organization, and in the size and strength of those with whom the large enterprise deals. The significance of a given percentage of an industry's output differs with differences in the nature of cost and demand and in the ease with which new competition can appear. No uniform limit upon size would be equally appropriate to a glove manufacturer, a steelmaker, a food chain, and a building contractor. If there were a uniform ceiling upon assets, it would be either meaninglessly large for industries where small-scale operation prevails or unduly small for industries that require large establishments. If there were a rigid limitation upon the percentage of an industry to be controlled by a single concern, changes in the definition of the industry could change the practical effect of the stated percentage by changing the base upon which it was computed. Moreover, there would be need to modify such a percentage to take account of the large place that the first pioneers occupy in a new industry, and doubtless of other anomalous circumstances not readily foreseen.

An absolute ceiling upon size would be undesirable as well as impractical. It would reduce the vigor of competition by destroying the incentive for enterprises to struggle for more business after they had almost reached their permitted maximum. Without such an incentive, these concerns would have little inducement to keep their prices down, their business methods efficient, and their technology dynamic. Instead they might be expected to develop a willingness to let well enough alone, to follow traditional methods, and to raise prices if they could do so without serious reduction of sales. Thus they would be led to behave more like monopolists than competitors.

Since no rigid ceiling of permissible size can be set for large enterprises, the attack upon excessive power must consist in a series of proceedings against particular examples of such power. The development of such an attack necessarily involves discovery of standards for determining whether or not excessive power is present or imminent in particular cases.

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evidence of excessive concentration of economic power. For a carefully developed suggestion intended for application in the United States, see Fred I. Raymond, *The Limitist,* W. W. Norton & Company, New York, 1947.

THE STANDARDS FOR IDENTIFYING MONOPOLY POWER

Different standards are needed to cope with the three broad types of economic power—monopoly (or monopsony), vertical integration, and gianthood.

Public discussion and public policy have concerned themselves primarily with problems of monopoly power. Monopolies and attempts to monopolize are forbidden by Sec. 2 of the Sherman Act and combinations in restraint of trade are forbidden by Sec. 1 of the same statute. Judicial decisions have made clear that the term *monopoly* in this law need not mean production or sale of the entire supply.[42] Control of the market is sufficient to constitute an unlawful monopoly. The decisions have failed to discriminate sharply between monopolies and combinations in restraint of trade. Indeed, in procedures against corporate combines as unlawful combinations it has been clear that the courts have interpreted the term *restraint of trade* as the equivalent of monopoly or of an attempt to monopolize and have refrained from giving it the same meaning which would attach to it in a case of collusive agreement.[43]

[42] In *Standard Oil Company of New Jersey v. United States,* Chief Justice White stated: "The commerce referred to by the words 'any part' construed in the light of the manifest purpose of the statute has both a geographical and a distributive significance, that is, it includes any portion of the United States and any one of the classes of things forming a part of interstate or foreign commerce." (221 U.S. 1, 61.) And again, "The inference that no attempt to monopolize could have been intended, and that no monopolization resulted from the acts complained of, since it is established that a very small percentage of the crude oil produced was controlled by the combination, is unwarranted. As substantial power over the crude product was the inevitable result of the absolute control which existed over the refined product, the monopolization of the one carried with it the power to control the other. . . ." (221 U.S. 77.)

[43] Again in the Standard Oil case, in tracing the development in English and American law of the concepts "monopolize" and "restraint of trade," Chief Justice White said: ". . . while the principles concerning contracts in restraint of trade, that is, voluntary restraint put by a person on his right to pursue his calling, hence only operating subjectively, came generally to be recognized in accordance with the English rule, it came moreover to pass that contracts or acts which it was considered had a monopolistic tendency, especially those which were thought to unduly diminish competition and hence to enhance prices—in other words, to monopolize—came also in a generic sense to be spoken of and treated . . . as restricting the due course of trade, and therefore as being in restraint of trade.

"Undoubtedly, the words 'to monopolize' and 'monopolize' as used in the section

The courts have vacillated in determining the meaning of monopolistic control of the market. In some decisions sale of a heavily preponderant part of the total supply has been regarded as evidence of unlawful control.[44] Apparently in these cases substantial weight was given to occupancy of the market as a test of monopoly.[45] In other decisions, mere size has been said to be no offense and evidence of control has been sought in the behavior of the large enterprise.[46] Here monopoly apparently was thought to be a matter of conduct rather than of occupancy. The relative importance of these two concepts has never been clarified. In practice, prosecutions on a charge of monopoly usually proceed on the assumption that preponderant occupancy of the market and monopolistic behavior should both be proved.

The confusion of the cases is due to the fact that there are several pos-

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reach every act bringing about the prohibited results. The ambiguity, if any, is involved in determining what is intended by monopolize. But this ambiguity is readily dispelled in the light of the previous history of the law of restraint of trade . . . and the indication which it gives of the practical evolution by which monopoly and the acts which produce the same result as monopoly, that is, an undue restraint of the course of trade, all came to be spoken of as, and to be indeed synonymous with, restraint of trade." (221 U.S. 56-57, 61.)

It is clear that, for example, the judicial interpretation of price fixing by collusive agreement as per se unreasonable restraint of trade does not extend to the establishment by a corporate combine of prices for its own product, and such a combination to be in restraint of trade must be "thought to unduly diminish competition and *thus* to *enhance* prices." See also Judge Hand's decision in the Alcoa case, 148 F. (2d) 416.

[44] *Standard Oil Company of New Jersey v. United States,* 221 U.S. 1; *United States v. American Tobacco Company,* 221 U.S. 106; *United States v. Terminal Railroad Association of St. Louis,* 224 U.S. 383; *United States v. Aluminum Company of America,* 148 F. (2d) 416; *American Tobacco Company et al. v. United States,* 328 U.S. 781. See also Milton Handler, *Cases and Other Materials on Trade Regulation,* p. 443, The Foundation Press, Inc., Chicago, 1937, for a chart of capital combination decisions.

[45] All the decisions cited, with the possible exception of the Alcoa decision, were accompanied by findings of predatory practices by the defendants. No decisions have been clearly based upon occupancy alone.

[46] *United States v. United States Steel Company et al.,* 251 U.S. 417; *United States v. International Harvester Company,* 274 U.S. 693; *United States v. The New York Great Atlantic and Pacific Tea Co., Inc. et al.,* 147 F. (2d) 416. The Steel and Harvester decisions were complicated by the court's findings that the defendants did not in fact possess the power to fix prices unilaterally. The dictum that mere size is no offense was modified considerably in *United States v. Swift and Company et al.,* 286 U.S. 106, and more recently in the aluminum and tobacco decisions cited above.

sible standards for identifying monopoly power and that each possesses inherent difficulties.

The first standard rests upon the alleged impersonality of the competitive process. The main tradition of economic theory implies that concerns should be so numerous and so small that no one of them can single out any of its competitors for individual attack in the market and that no one will be able to determine its own policies in the light of another's anticipated reactions thereto.[47] In other words, it suggests that, to be effective, competition must be impersonal. In most of American industry competition fails to meet such a standard. Particular commodities are made by a limited number of enterprises, are distributed by relatively few wholesalers, and pass into the hands of retailers who compete with one another in limited groups in local markets. Short of a drastic reorganization of American economic life, impersonal competition is likely to be the exceptional case. However, the need for impersonal competition has been overemphasized in economic thinking because such relationships are part of the theory of the perfect competitive market. The standard of competition upon which the present discussion rests is more modest than this. It relies, not upon the presumption that competition will assure the perfect functioning of the economic system, but rather upon the usefulness of competition in enabling traders to safeguard themselves against extremes of exploitation, lethargy, and incompetence by turning to the most satisfactory of a number of alternatives, actual and potential. Business maneuvers that are directed against identified competitors are not inherently inconsistent with the maintenance of such alternatives. Thus the competition which is here at issue does not exact an impersonal relationship among the competitors.

The second standard is that of occupancy of the market, mentioned above. As has already been indicated, control of a given percentage of an industry's total output may have varying effects dependent upon variations in demand and cost and in the ability of competitors to increase their sales; and the complete occupancy of new industries by one or more pioneers is inevitable. Moreover, the boundaries of an industry are typically so uncertain that the percentage represented by the operations of a particular large business enterprise may be arbi-

[47] For a summary of the postulates of price theory based on the concept of the purely competitive market, see George J. Stigler, *The Theory of Price,* p. 21, The Macmillan Company, New York, 1946.

trarily enhanced or reduced by redefinition of the industry itself. Perceiving the difficulty of using mere occupancy as a standard for determining monopoly power, the courts have been reluctant to accept this test. They have looked for other evidences of control in the behavior of the large enterprise.

The third standard for determining monopoly power rests upon an identification of monopolistic behavior. In economic theory, monopoly consists in ability to raise prices and enhance profits by restricting output and to discriminate in prices between different purchasers.[48] Unfortunately, these tests of monopoly are difficult to formulate in such a way that they describe identifiable types of market behavior. Sellers generally charge as much as they can, whether they are monopolists or competitors. Indeed, desiring to protect their long-run monopoly position, monopolists sometimes show more self-restraint than competitors in avoiding price increases. In actual markets, as distinguished from ideally perfect ones, competing concerns often determine in advance the prices at which they will attempt to sell and the amounts which they believe the market will absorb. Since markets are imperfectly organized, competing sellers can charge different amounts in different transactions and thus discriminate in price. Competing enterprises sometimes make high profits, and monopolies sometimes lose money. Production at less than capacity is a commonplace in competitive markets; indeed, a monopoly which has exercised control for a considerable period of time may have limited its capacity to what it can profitably use and therefore may have less idle capacity than many competitive enterprises. Thus advance determination of prices, price discrimination, limitation of output below capacity, and the level of profit are all unreliable guides for the identification of monopoly power.[49]

Such tests of monopoly power do not provide a satisfactory basis for distinguishing between inherent power and the advantages that some enterprises derive from the customs and inherent imperfections which characterize certain markets. Some concerns enjoy sheltered positions because of the popularity of their brands, the lethargy of their cus-

48 See Alfred Marshall, *Industry and Trade,* pp. 196, 399-402, 404-405, and 415-418, Macmillan & Co., Ltd., London, 1923.

49 However, these characteristics are, of course, by definition conclusive evidence of the absence of the "pure competition" postulated in conventional price theory. See Jacob Viner's article, "Objective Tests of Competitive Price Applied to the Cement Industry" (February-December, 1925), *The Journal of Political Economy* 33, 107-111.

tomers (which they are likely to describe as good will), or the fact that their competitors are distant and difficult of access.[50] Moreover, since business conditions fluctuate, since the future is uncertain, and since there are limits to the frequency and speed with which managerial plans can be changed, competitive policies are often somewhat rigid and temporarily inconsistent with the play of competitive influences in the market. Indeed, some concerns will play safe and refuse to spoil the market when prices are relatively high and operations are below capacity, even though a sharp computation of pecuniary advantage might suggest that lower prices and larger sales would be wise.

Practices in changing prices are somewhat better tests of monopolistic behavior than the level of prices. A concern that possesses monopoly power is usually the initiator of price increases, and a monopoly is usually slow in adjusting its prices downward to meet changing conditions. Nevertheless, these tests are not infallible. The speed of price adjustment is substantially affected by the nature of the commodity and the traditions of the industry.[51] Concerns without appreciable monopoly power are in some cases habitual leaders in changing prices. Where monopoly power is shared among two or more concerns in the same industry, no customary leadership in changing prices may be visible.

Thus, at best, evidence that market behavior is monopolistic accumulates gradually as high prices, price discriminations, restrictions of output, high profits, and practices in changing prices provide cumulative evidence that policies appropriate to competition are not being followed. The law has developed no clear conception of the nature of monopolistic exploitation of the market. Attention has been given to the level of prices and profits, to the existence of exceptional degrees of price discrimination, and to suppression of technology. Information about percentage control of resources, capacity, and current

[50] See TNEC Monograph No. 1, *Price Behavior and Business Policy*, pp. 75-76, 80-81. See also Clair Wilcox, "Brand Names, Quality, and Price," *The Annals of the American Academy of Political and Social Science*, May, 1934, pp. 80-85. See also TNEC Monograph No. 24, *Consumer Standards*, pp. 315-317.

[51] For example, in their analysis of the practice of price lining, the authors of TNEC Monograph No. 1 conclude that the practice restricts the scope of price competition and point out with emphasis that ". . . this conventional restriction of price competition is in no sense associated with concentration or with any manifestation of monopoly power. Most of the industries in which price lining is prevalent are composed largely of small enterprises and are by almost any criterion highly competitive." (Pp. 74-75.)

production has been treated as relevant in interpreting these phenomena. The evidence used has often been capable of conflicting interpretations.

A second type of monopolistic behavior is easier to recognize. This is coercion of competitors or adoption of policies designed to single out and destroy particular rivals. Coercive and selectively destructive tactics often differ sharply from those of ordinary competitive rivalry, and for this reason afford a convenient test of monopoly power.[52] In antitrust cases various devices of this kind have been identified and condemned—local price cutting,[53] preemption of necessary facilities,[54] price discrimination,[55] use of tying contracts,[56] and efforts to buy out competitors under threat of ruin.[57] Such practices are persuasive evidence that an attempt is being made to create or maintain a monopoly, and thus provide grounds for prosecution under our present law. But they do not prove that a monopoly has actually been achieved or maintained, for a concern that fails to obtain or hold monopoly power may use coercive tactics as aggressively as one that succeeds, and may be successful in many individual acts of coercion in spite of its failure to achieve its central purpose. Furthermore, an established and unchallenged monopoly has no need to destroy its remaining rivals or to use overt coercion in order to induce them to accept its discipline. Thus, although the tests of coercion and selective destruction of competitors tend to identify the concerns that want monopoly, these tests may fail to indicate those that have firmly achieved it. In spite of these limitations of the concept, judicial decisions that test monopoly by behavior appear to rely primarily upon the oppressive treatment of competitors.

Most of these difficulties are inescapable. Nevertheless, part of the

[52] See pp. 157-179.

[53] For example, *United States v. Standard Oil Co. of New Jersey*, 221 U.S. 1, and *United States v. American Tobacco Co.*, 221 U.S. 106.

[54] For example, *United States v. Terminal Railroad Association of St. Louis*, 224 U.S. 383, and *United States v. Aluminum Company of America et al.*, 148 F. (2d) 416.

[55] See *United States v. The New York Great Atlantic and Pacific Tea Company, Inc. et al.*, 147 F. (2d) 416, for a condemnation of the buying and selling practices of A & P's subsidiary, Atlantic Commission Company. See also the early oil and tobacco cases.

[56] *United States v. Ethyl Gasoline Corporation*, 309 U.S. 436. *United States v. United Shoe Machinery Corp.*, 258 U.S. 451. The latter was a proceeding under the Clayton Act.

[57] *United States v. Standard Oil Company of New Jersey*, 221 U.S. 1.

trouble lies in the failure to recognize consistently that there is a middle ground between mere occupancy of the market on the one hand and exploitative and coercive conduct on the other. The analysis upon which this volume is based suggests an intermediate test. The number of concerns should be regarded as unduly small when the buyer no longer encounters substantial variations in business policy,[58] whether the uniformity which has become good business practice is due to a single control, to agreement, or to mutual forbearance among a few large enterprises. In reasonable precaution against such developments, enterprises should be regarded as too few whenever their number is so small as to entail substantial risk that their policies will not vary. Large concerns should be considered too big whenever one or two of them are so large relative to the others that recourse to the smaller concerns is unlikely to afford buyers adequate alternatives for escape from the policies of the larger ones. This conception involves a substantial enlargement of the present legal idea of control of the market.[59] However, it springs directly from the purpose of the competitive policy, and it is capable of providing a standard of judgment which is somewhat less ambiguous than the available alternatives.

Similarly, the test of coercion should be broadened. There is no need to abandon the principle that a concern is too large relative to its fellows when it habitually engages in acts of intimidation and coercion against them. However, the power to coerce is even more significant than acts of coercion. The strongest concerns seldom need to use coer-

[58] A company that produces various products and sells them through different distributive channels in different markets may have a considerable number of different policies applicable to different types of transactions. Diversity of this sort is irrelevant to the type of uniformity in question. If designated classes of buyers, who obtain designated products through designated market channels, can no longer obtain different treatment by turning to other sellers, variety has disappeared, no matter how differently these buyers may be treated from other buyers who also encounter uniform, though different, treatment.

[59] Efforts to cope with the problem presented by a small number of large concerns in an industry have been based upon an attempt to prove collusion among them. The conception of collusion has been stretched to include various forms of tacit and indirect collusion and toward the view that power is objectionable whether or not it is exercised. The drift of the law is toward the view that the mere size and fewness of large concerns may in itself establish an illegal relationship. However, this principle is not yet explicit in the decisions. See *The American Tobacco Company et al. v. United States,* 328 U.S. 781. See also Corwin D. Edwards, "Can the Anti-trust Laws Preserve Competition?" in *Readings in the Social Control of Industry,* Blakiston Series, The Blakiston Company, Philadelphia, 1942.

cive tactics, because disparity in power is so great that competitors are docile. A concern is too large when the policies of its competitors are controlled by the possibility of being coerced. In reasonable precaution against coercive tactics, concerns that obviously have coercive power should be regarded as excessively large.

A combination of the two tests of power to exploit and power to coerce would constitute the most satisfactory basis for identifying monopoly power. Under these tests, monopoly power might be enjoyed by more than one enterprise in the same industry. Short of so fundamental a change in legal concepts, there is little hope that the vigor of competition can be preserved in the face of trends toward larger business units with more concentrated bargaining power.

THE STANDARDS FOR IDENTIFYING OBJECTIONABLE TYPES OF VERTICAL INTEGRATION

Standards appropriate to cope with the power of vertically integrated business enterprises are also needed. The present law cannot be easily focused upon this type of power. The only prohibition applicable to such a concern is the Sherman Act's general condemnation of monopolies and combinations in restraint of trade. But as has been indicated earlier in this chapter, the power of the vertically integrated enterprise is traceable to disproportionate size at different stages of its productive process rather than to absolute size; and this power may be enhanced if the integrated enterprise enjoys a legal monopoly in one of its operations. The conception of restraint of trade may be capable of including such power. Nevertheless, more certain and more fully appropriate safeguards would be desirable.

The problem of vertical integration divides naturally into two parts: extension of lawful monopoly power and acquisition of power through disproportionate integration.

The first should be dealt with by flatly prohibiting an enterprise that enjoys a legal monopoly of some field of business activity[60] from also undertaking commercial activity in which monopoly is unlawful. There is no effective way in which, if such a union of activities is per-

[60] Such legal monopolies of fields of activity should, of course, be distinguished from legal monopolies of particular inventions, such as are conveyed by patents. The latter type of monopoly does not *necessarily* lead to a similar leakage of monopoly power, though it may do so. For a discussion of patent monopolies, see pp. 216-248.

mitted, the monopolist can be prevented from extending the scope of his monopoly power.

To prevent disproportionate integration is much more difficult. Opportunities to integrate vertically must be left open in order to avoid freezing the pattern of industry into the conventional successive stages which prevail at a given time. Technological considerations may make it difficult or unreasonably expensive for a concern that undertakes vertical integration to choose between supplying all or none of its own requirements. Similarly, a concern that is already integrated may encounter technical difficulties in expanding at a uniform pace at each stage of its operations. For example, a dam cannot be economically built in increments but must be large enough to anticipate future needs. Hence disproportionate growth is to be expected. The policy of the law should be designed, however, to challenge substantial disproportions where better proportioning would be technologically possible, and to prevent the vertically integrated enterprise from controlling so much of the total supply at any stage of production or distribution that adequate alternatives are unavailable to independent enterprises operating at preceding or subsequent stages. Such a policy would necessarily be expressed in a broad statute which would acquire explicit meaning gradually through decisions in test cases.

STANDARDS FOR PREVENTING EXCESSIVE SIZE

Standards are also needed to cope with excessive power derived from excessive over-all size rather than from monopoly in particular industries. The power of the business giant consists in ability to coerce others, to close channels of opportunity, and to obtain special privileges in its dealings with those who should serve all comers impartially: for example, banks, common carriers, law courts, government executives, and legislatures. A concern is too large when it has coercive power or is habitually able to obtain discriminatory privilege.

The present law does not provide protection against this kind of power. The law has been developed around the concept of monopoly in a single industry and is blind to problems of size that may be of even greater importance. Efforts have been made, notably in a recent case against The Great Atlantic and Pacific Tea Company,[61] to stretch the Sherman Act to cover oppressive exercises of power based upon ag-

[61] *United States v. The New York Great Atlantic and Pacific Tea Co., Inc.,* 67 F. Supp. 626.

gregate size rather than upon monopoly position. It has been necessary, however, to winnow the evidence in such cases in order to obtain from it proof that at some point the power took the form of monopoly or was used to eliminate competition. Even the broadest interpretation of the Sherman Act is not likely to make it a convenient weapon against such concerns.

The law should be amended or supplemented to prohibit this type of concentration of power. Two alternatives are available in doing so. One is to prohibit excessive size that gives excessive power and, subsequently, to identify the evil case by case by applying the broad language of the statute to particular situations, as is now done with respect to monopoly and collusion under the Sherman Act. This alternative would have the advantage of flexibility and would entail the minimum of risk that harmless or even beneficial types of bigness might be prevented. But there is great danger that this form of attack would be ineffective. It is improbable that a satisfactory statute can be devised upon the analogy of the present Sherman Act. To determine when the power of the business giant has been achieved is even more difficult than to identify an industrial monopoly. Sprawling over many industries, a large concern is likely to have many sources of power and privilege and to derive its strength from a combination of all of them without necessarily enjoying a crucial advantage from any one source. In some cases the channels of opportunity are choked for small enterprises, not by the individual action of a single large rival, but by a structure of markets, credit facilities, and governmental processes which has been adapted to serve big enterprises and is therefore inappropriate to the service of small ones. Because of such conditions, the aggregate effect of bigness is likely to be more obvious than the exact points at which the effect is produced. To cope with such problems by conclusively proving that particular enterprises are excessively big may be impossible.

The second alternative is to establish a rebuttable presumption against bigness in excess of some relatively high level of size. Assuming that bigness is typically dangerous and therefore objectionable, such a policy would tolerate the large enterprise only where bigness could be shown to be necessary to the public interest. It would place the burden of proof upon the large enterprise to justify its existence. In practice, such a policy probably would mean that the conglomerate concern without monopoly power would be required to justify any size

greater than that appropriate to technological and administrative efficiency in our larger scale industries. The defenses against excessive concentration of power would be much stronger with this method of attack than with the first alternative. But some harmless growth probably would be prevented, and even desirable growth might be sometimes discouraged by the requirement that it be justified. Because of the probable ineffectiveness of the first alternative, the second is preferable in spite of this defect.

The application of this type of policy would require enactment of a law in which undue concentration of control over business activity would be declared contrary to the public interest and under which, above permissible limits set forth in the statute or to be declared by a suitable administrative authority, acquisitions of control would require explicit sanction on grounds of public advantage, and control already established would be subject to dissolution unless its necessity were proved. It would be essential to the effectiveness of the statute that the government be empowered to prevent or destroy the concentration because of its size alone, and that the test of public advantage be merely an exemption available to the enterprise upon presentation of adequate proof. Because of the magnitude of the dissolution problems involved in the initial stages, it would be necessary to provide for periods of grace during which readjustment could be brought about, and for some form of government agency to consider dissolution plans and to lengthen periods of grace upon proper showing of cause.

The standards suggested above are not simple to apply. They are stated in broad language, which offers no simple quantitative means to identify a concentration of economic power. They can be applied only by study of the behavior of particular large concerns and the environment in which that behavior takes place. They can only acquire detailed meaning through the growth of a body of precedents derived from decisions in particular cases. If these characteristics are not virtues, they are inevitable necessities. The present law of monopoly is also broad, nonquantitative, and dependent upon development by precedent. Since there are relatively few large enterprises and the treatment of each must decide the organization of a substantial segment of the economy, a case-by-case approach is more appropriate to the problem of business size than to other problems of the competitive policy.

ENVIRONMENTAL CHANGES TO DISCOURAGE EXCESSIVE CONCENTRATION

But an attack upon the concentration of economic power should not be limited to an effort to correct particular corporate excesses. It should include a second type of policy designed to alter the environment by removing conditions and privileges that strengthen large enterprise and weaken small enterprise. Success in this portion of the policy should make great size more difficult to attain.

In the endeavor to make the environment less favorable to big business, several lines of action are appropriate. The more significant are discussed briefly below.

Reform of Corporation Laws

The opportunity to create large business units has been enhanced and the ability of government to cope with big business has been reduced by peculiarities of modern corporate organization. Control over the property interests of minority groups is inherent in the corporate device. Through a succession of holding companies a relatively small property interest may become the basis for control of a large organization.[62] Through intercorporate stockholdings, interlocking directorates, and similar devices, nominally independent interests may be united in a common policy. A single controlling group may wear a diversity of corporate masks, thereby concealing the locus of control and the fact that business policy has been unified.[63] Intricate maneu-

[62] Such possibilities have been carried furthest in the public-utility field. In the Standard Gas and Electric Company system an investment of less than 1 million dollars controlled assets of more than 370 million dollars. Electric Bond and Share Company controlled 851 million dollars of assets in American Power & Light Company with an interest representing only 3.42 per cent of the capitalization. Similarly, it controlled 750 million dollars of assets in Electric Power & Light Company, yet held only an 8.72 per cent interest in that company. See *Tenth Annual Report* of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1944, p. 60.

[63] In one such case, involving a Chilean enterprise, "The legal structure of the business was so arranged that in Chile there exists no official record of the fact that the company is owned by Sterling Products and Leverkusen. . . . The documents covering the transfer of Pando's 75% share to Dr. W. E. Weiss (as trustee for Leverkusen) and of Hegemann's 25% share to Sterling Products, Inc., were drawn up and signed in Buenos Aires, and legalized by the Argentine Foreign Office and the U.S. Consul General in Buenos Aires. The Lab. Hegemann, of course, will

vers in the power politics of corporations may become the principal center of business attention and the principal determinant of business success, diverting the attention of businessmen from simple forms of competition in production and sale.

In the competition of state legislatures for incorporation fees and taxes, the safeguards of the public interest which once surrounded the right to incorporate have been almost wholly removed. It has become progressively easier to organize great business combinations and to hide what one is doing. Substantive changes in the law designed to impose new duties and responsibilities upon corporations are desirable for many reasons, one of which is that they would make excessive size more difficult to achieve.

The first and most obvious change needed for this purpose is a requirement that every corporation disclose its corporate affiliations and the names of those who hold its securities.[64] Under present practice competitors, customers, creditors, or the government itself cannot readily know whether one corporation which is nominally an independent business unit is actually controlled by another.[65] A single business interest masquerades under many disguises. Several business enterprises may form an alliance which they organize separately as a single and apparently independent corporation. Outsiders do not know with whom they are dealing[66] and whether they confront one

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be operated as an entirely separate entity, so as to make it appear to outsiders that the 'Alviol' and Aspirin businesses are still competing with each other." See Corwin D. Edwards, *Economic and Political Aspects of International Cartels,* p. 52.

[64] Under the Securities Act of 1933, corporations that desire to sell their securities to the public through the mails or in interstate commerce must file with the Securities and Exchange Commission a registration statement which supplies material facts about the company. Under the Securities Exchange Act of 1934 securities must be registered before they are eligible for trading on a national securities exchange. Neither of these registration requirements provides for full disclosure of ownership, control, and interlocking business relationships. Moreover, companies that are not listed upon registered exchanges and have not floated any security issues are not covered. See *Tenth Annual Report* of the SEC, pp. 2, 25.

[65] For example, General Aniline & Film Corporation was seized by the alien property custodian during the war on the ground that the Swiss company, I. G. Chemie, which controlled it, was controlled in turn by I. G. Farbenindustrie. This contention became a matter of dispute before a Swiss compensation commission early in 1947. See *Chicago Sun,* Feb. 25, 1947. After this volume was in press, the Swiss commission held that I. G. Chemie was a Swiss, not a German, concern.

[66] In 1944 private litigants, desiring to sue N. V. Philips Gloeilampenfabrieken, found themselves unable to determine whether jurisdiction over the matter rested

interest group or many. Application of a government policy which seeks to discriminate among business enterprises according to their relationship or the status of those who control them is likely to bog down in controversy about the facts of ownership and control. Until this game of corporate blindman's buff is ended, the size of business units cannot be readily discovered nor effectively controlled.

Almost equally important are changes of corporation law designed to make it more difficult for one corporation to control another. To this end the powers of corporations to own the securities of other corporations should be reduced, limits should be placed upon intercorporate loans, and interlocking relationships among corporate officers and directors should be restricted. Under the laws of American states corporations once commonly lacked the right to own stock in one another; and the abandonment of this principle, inaugurated by the state of New Jersey, was candidly devised in order to facilitate the growth of monopoly.[67] What is needed is a return toward older and sounder principles of corporate organization.

The appropriate limits of such a policy may reasonably be subjects of dispute. On the one hand, there is clearly no need to destroy the right of insurance companies to invest their reserves in corporate securities, the right of investors to diversify their risks through investment trusts,[68] nor the right of banks to make security investments as well as loans. At the other extreme, there is clear need to prevent competing corporations from pooling their interests by organizing joint subsidi-

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in a Connecticut court or in a court in the District of Columbia, because this question depended upon the terms of a secret agreement which established a Hartford bank as trustee for the Philips Company. The suit was brought in the District of Columbia; the defendants contended that it should have been brought in Hartford. Since even the allegations of the defense are not conclusive upon such a question of jurisdiction, the plaintiffs persuaded the court to order a special examination of a vice-president of the Hartford bank as to the jurisdictional issue. Even during this proceeding, the trust agreement was not produced, and the witness refused to answer many questions about its contents. See *Joseph H. Skehan, George J. Agule, and Machlett Laboratories v. N. V. Philips Gloeilampenfabrieken et al.*, civil action No. 23,370, District of Columbia, Deposition of William B. Dana, May 26, 1944.

67 *The Autobiography of Lincoln Steffens,* Part 2, Sec. 3, Harcourt, Brace & Co., New York, 1931.

68 However, an investment trust may easily become the basis for a corporate combine by acquiring and keeping controlling interests in several corporations. Hence care should be taken to specify that any special tolerance accorded to investment trusts is conditioned upon small and diversified and frequently changing holdings of securities by them.

aries and to prevent the authority of a controlling group from being extended by erection of a pyramid of holding companies through which the top company's control becomes much wider than its ownership. Between these two extremes lie problems whose answers are less obvious: whether a corporation should be allowed to divide its risks, debts, and earnings by organizing wholly owned subsidiaries; whether nonfinancial corporations should be allowed to invest in each other's stock; whether noncompeting corporations should be allowed to undertake joint ventures through separate corporations jointly owned; and whether limited extensions of control beyond ownership through the holding-company device should be permitted. The simplest and clearest procedure would be to require each corporation to be a separate unit in fact as it is in legal theory; and such a requirement would minimize the opportunity to extend the size of the business unit by manipulative devices devoid of technological and administrative usefulness. However, some forms of intercorporate stockholdings are alleged to be both useful and harmless. For example, the segregation of related business interests into two or more corporate units is often used to separate projects that have different degrees of risk, to finance some of these projects by methods inappropriate to the enterprise as a whole, and in other similar ways to increase the flexibility of financial management. If such activities are thought important enough to justify retention of certain types of intercorporate stockholdings, they can be preserved without permitting hierarchies of control similar to those now tolerated.

There is no need here to select the exact limitations upon interlocking ownership which would be most appropriate.[69] What is important is that effective measures be adopted to prevent great corporate combinations from being built up by interlocking ownership interests and to eliminate types of interlocking ownership that destroy competition between the owners.

[69] Among various types of restriction of the right of corporations to hold securities which might be considered are the following: (1) prohibition of all security ownership, with exemptions for holdings by designated types of financial institutions; (2) prohibition of ownership of voting securities, with similar exemptions; (3) limitation of the proportion of a total security issue which may be owned; (4) prohibition of the voting of securities owned; (5) prohibition of ownership of a controlling interest; (6) prohibition of ownership of a controlling interest if the corporation controlled controls a third corporation; (7) prohibition of ownership in any corporation in which there is also an outside ownership interest.

Similarly, nonfinancial corporations should be prevented from extending loans to other corporations in such amounts and on such terms as give the creditors control over the debtors. In cases in which, after default of a loan, the capital assets of the debtor corporation are acquired by a creditor corporation, there should be a requirement that these assets be sold within a limited period. Such limitations upon lending power should be drawn to provide as much flexibility as is consistent with the objective to prevent a creditor position from being used as a basis for expansion or for control.

Other changes in corporation law should prevent the establishment of systems of control based upon interlocking offices [70] and directorates. Except in the case of such subsidiaries as are permitted by law, no policy-making officer of one corporation should be permitted to be a policy-making officer of another.[71] A basic inconsistency should be recognized in any such effort to make policy decisions for two or more supposedly independent concerns at the same time. To assure an actual separation of interests, persons should be ineligible to offices in a corporation if, individually or with other officers, they hold a controlling interest in the stock of another corporation. In the case of directorates, as distinguished from corporate offices, the rule should be less rigid, since a diversity of opinions and interests may properly be represented on a board of directors. However, the number of directors that any two corporations (other than parents and their lawful subsidiaries) may have in common should be so limited as to assure that control of the separate corporations is not exercised by the same group.

Moreover, precautions should be taken to prevent evasion of these principles by the establishment of interlocking relationships which depend upon the unity of a family, a law firm, or some similar closely associated group of individuals. Wherever an individual is not eligible to be an officer or director of a corporation, the ineligibility should extend to his immediate relatives and his close business associates. It would be hopeless to identify and forbid specifically each device by

[70] As discussed here, policy-making offices include not only the top executive positions within the corporation but also the chairmanship of the board of directors and of any executive committee or policy-making subcommittee of that board.

[71] To cope with problems of monopoly and excessive concentration, this principle need be invoked only in the case of relatively large corporations; but since the relationship to be forbidden is inherently questionable, the rule might well be made generally applicable.

which the formal prohibition of personal interlocks between corporations may be evaded. Instead, enterprises nominally independent should be forbidden in broad terms to develop such interconnections through officers, directors, management contracts, or other devices of similar import as are likely to have the effect of bringing about a joint or parallel determination of policy; and procedures similar to those that are commonly used under the antitrust laws should be invoked to determine the application of this broad principle in particular cases.

So long as corporations may be organized under the most lax corporation law provided by forty-eight states competing in laxity, there is no possibility that limits like those described above will be imposed. Consequently, a necessary first step in reforming American corporation law is to provide for Federal incorporation of all enterprises engaged in interstate or foreign commerce. Only if the legal policy is unified can it be reformed.[72]

The present corporation laws of the various states do not contain these safeguards. An effort has been made, however, to write certain provisions for information into Federal law. Disclosure of corporate structure is required under the Securities Act of 1933 and the Securities Exchange Act of 1934 as a prerequisite to the marketing of new securities in interstate commerce and the registration of securities upon organized exchanges. In theory the disclosure requirement is incomplete, since it has no bearing upon concerns which neither have registered on an exchange nor issued new securities.

In practice, moreover, the enforcement of this requirement has not been systematic, and many of the more important facts about the structure of great corporations which have floated securities have remained secret.

In the absence of safeguards in our corporation laws, an effort has been made in the antitrust laws to erect barriers against tendencies toward monopoly that grow out of the control of one corporation by another. Sections 7 and 8 of the Clayton Act, enacted in 1914, had this purpose. However, these provisions made no attempt to prevent the

[72] This suggestion is not intended to recommend that enterprises incorporated in other countries be forbidden to do business in the United States without reincorporation here; but foreign corporations should be required to conform to substantive standards equivalent to those contained in American corporation law. Moreover, an exemption permitting concerns of small size to avoid Federal incorporation would not impair the effectiveness of the proposal.

creation of great aggregates of power by uniting corporations that were not in competition with one another.

Section 7 forbids holding companies to acquire the stock of two or more corporations engaged in commerce where the effect may be to substantially lessen competition between these corporations or to restrain commerce in any section or community or to tend to create a monopoly in any line of commerce. It also forbids one corporation engaged in commerce to acquire stock in another where competition between the two may be substantially lessened or where there will be similar effects of restraint or monopoly. The prohibition does not apply if stock is acquired solely for investment and is not used to control corporate policy or if the controlled corporation has been created as a subsidiary by the controlling corporation. The statute governs only future acquisitions and does not impair rights already acquired.

The intent of this part of the Clayton Act was to forestall the development of monopolies and of restrictive practices based upon control of a large proportion of an industry by outlawing the stock acquisitions through which such results are often achieved. Stock acquisitions which went so far as to constitute attempts to create a monopoly were already unlawful under the Sherman Act. The Sherman Act test was retained in this provision in slightly broader form.[73] In addition the provision invoked two new tests: (1) restraint of commerce, not merely throughout the industry, but in any section or community, and (2) substantial reduction of competition between the corporations immediately involved. The first of these two new tests is broader than that of the Sherman Act in so far as restraint of trade within a particular community may be less than monopoly of a part of commerce. On its face, the second test amounts to a practical prohibition of the purchase of any considerable part of the securities of a competitor, since a substantial reduction of competition between the two companies would be the inevitable result.

The scope of this section has been greatly reduced by judicial interpretation. When efforts were made to prevent competing companies from being united by stock acquisitions on the ground that competition between them would be thereby reduced, the courts held that com-

[73] Whereas the Sherman Act prohibits an attempt to monopolize any part of trade or commerce, the Clayton Act makes stock acquisitions illegal if they tend to create a monopoly of any line of commerce. There may be doubt whether a line of commerce is appreciably different from a part of commerce. There can be no doubt that a tendency to create a monopoly may exist even without an attempt to do so.

petition would not be substantially reduced if the companies in question were primarily engaged in serving different classes of customers[74] or if both together produced such a small proportion of the total output that their union would have no substantial effect upon the market.[75] Since combinations that substantially reduce competition throughout the market probably tend to create a monopoly and are probably illegal under the Sherman Act, these decisions nullified the most important change that had been attempted in this section of the Clayton Act. Moreover, they made it very difficult to prevent stock acquisitions in cases in which companies had differentiated their products and undertaken to serve different groups of customers. They ignored potential competition, in spite of the fact that the statute is worded to cover cases in which the prohibited effects "may" occur.

The procedural limitations which the courts have imposed upon enforcement of the statute have contributed to nullification. The Supreme Court has held that if stock illegally acquired is used by the acquiring corporation to bring about a merger of the assets of the two companies before the FTC begins suit, the commission is powerless to dissolve the merger.[76] Since the commission cannot begin a case until it has investigated the facts, this decision made it possible for any company that acquires control over another to escape the commission's jurisdiction by prompt acquisition of corporate assets after acquisition of stock. Furthermore, the Supreme Court has held that if, before the commission's final order but after proceedings against an illegal stock acquisition have been begun, the defendant uses his stock control to acquire the physical assets of the controlled company, the commission cannot order divestiture of those assets.[77] These decisions made it clear that the Clayton Act cannot prevent use of stock acquisitions as an intermediate device in acquiring the assets of competitors.

As a result of these various interpretations of the law, Section 7 of

[74] *International Shoe Company v. Federal Trade Commission,* 280 U.S. 291.

[75] *Temple Anthracite Coal Company v. Federal Trade Commission* [51 F. (2d) 656]; *Vivaudou, Inc. v. Federal Trade Commission* [54 F. (2d) 273]. These decisions were rendered by circuit courts, but in the light of the Supreme Court's holding in the International Shoe case, the Federal Trade Commission now appears to regard them as established judicial doctrine.

[76] *Thatcher Manufacturing Company v. Federal Trade Commission,* and *Swift and Company v. Federal Trade Commission* (272 U.S. 554).

[77] *Arrow-Hart and Hegeman Electric Company v. Federal Trade Commission* (291 U.S. 587).

the Clayton Act has been deprived of substantial effect. According to the commission, the record is "on the whole, clearly one of futility." [78]

So long as there is no Federal corporation law embodying the safeguards which have been proposed above, the strengthening of Section 7 of the Clayton Act would contribute substantially to the prevention of undue concentrations of economic power. The Congress should amend the law to make unmistakably clear in the language of the statute and by accompanying declarations of policy an intent to forbid stock acquisitions which destroy competition between the concerns directly involved. The most desirable way to accomplish this result would be to forbid all acquisitions of stock in competing corporations without any test of results. No public purpose is served by permitting the intermingling of control and investment among competing concerns, and therefore there need be no hesitancy in taking action as drastic as may be convenient. The need for caution in prohibiting stockholding relationships between corporations arises only if an effort is made to prevent the growth of great conglomerate combines by forbidding acquisition of securities in noncompeting corporations as well.

Section 8 of the Clayton Act is designed to prevent the development of a working community of interest among competing corporations by the use of interlocking directorates. It forbids any person to be at the same time a director in two or more corporations engaged in commerce that are or have been competitors, if any of these corporations has capital, surplus, and undivided profits aggregating more than a million dollars.[79] The specification of an owner's equity of a million dollars is presumably a rule of thumb designed to exempt small corporations.

In practice, this section has had little significance. It may have prevented the fortuitous development of parallel policies in corporations which, but for the law, might have chosen the same individual as director merely because of his personal prestige and without serious intent to use him as an instrument of collusion. However, where there are underlying influences that make for collusion, means to evade the

[78] *Report and Comment* of the Federal Trade Commission on HR. 2357 (79th Congress, 1st Session), p. 16.

[79] Exception is made for banks, banking associations, trust companies, and common carriers. Of these the first three are covered by another provision of the same section, forbidding any interlocking directorates among such financial institutions except under authorization from the Board of Governors of the Federal Reserve System or in the case of various specified types of banking institutions.

statute are easy to find. Persons who have large stockholdings in competing corporations may designate different individuals as directors but give them identical instructions as to policy. A director in one competing corporation may be blood relation, relation by marriage, employee, or partner of a director in another. With these possibilities open, the provision of the statute has usually been worth neither challenging nor enforcing.

Limited to these ineffective provisions, the present law fails to provide adequate safeguards against communities of interest. It contains no provisions against the development of a working accord among business enterprises through the personal relations of their officers, managers, and principal stockholders; no limitations upon the right to have identical executive officers, lawyers, accountants, banks, and advertising agencies; no legal barrier to prevent a single wealthy man or the members of a single family from owning the controlling stock interest in more than one ostensibly competing company. In summary, there has been no substantial effort to prevent competition from being destroyed by ties of ownership and management which unite ostensibly independent concerns.

Measures to Prevent Corporate Growth by Merger

A closely related type of precaution should consist in laws designed to prevent the enlargement of a corporation through purchase of the capital assets of another or through amalgamation with another. It is not sufficient to keep enterprises from being bound together by stockholdings, identity of officers or directors, and similar devices. The creation of one large concern out of two or more small ones is an easy way to build a giant enterprise. This can be done either by organizing a new company and dissolving those which it absorbs or by arranging for one company to acquire the assets of the others, thus attaining the total strength of the previously independent concerns and leaving the other companies as mere corporate fictions which possess only cash or stock to be distributed to the owners. Either process can be carried on as far and as swiftly as the strategy of power makes expedient.

To prevent such accretions of power there is need to curb acquisition of the assets of one corporation by another. Since ordinary business consists in large part of intercorporate purchases of property, it is not possible to adopt any blanket rule against property acquisitions. At most, the purchases to be prevented are those that bring the capital

assets of a going concern under new corporate ownership. However, even certain purchases of capital assets are harmless or desirable. There is no need to prevent one coal mine from buying a strip of land or a few pit mules from its neighbor. There is no need to worry if one small retail store acquires the entire premises of another and thus doubles the scope of its business. When a business enterprise goes bankrupt, others engaged in the same activities are often the logical buyers of the assets of the bankrupt concern. To recognize the propriety of acquisitions like these, it is necessary to allow corporations to purchase capital assets when the purchases are of negligible size or when the owner has ceased to be a going concern. Other similar immunities may prove to be needed. However, a rule of law should be established which forbids acquisition of any substantial part of the capital assets of a business enterprise, either in a single purchase or in a series of purchases, if the effect will be to increase appreciably the size of a great concern. In developing such a rule it would be appropriate to consider a graduated scale of prohibitions designed to prevent even relatively small transfers of capital assets to the largest enterprises and to apply standards less tight to acquisitions by concerns less large. It would also be appropriate to consider specifying a range of acquisitions that would be forbidden unless the enterprise desiring to make the acquisition successfully assumed the burden of proof that the public interest would be served rather than injured thereby.

Public policy does not now contain any prohibition against concentration of economic power through acquisition of assets except the broad provisions of the Sherman Act which forbid monopolies and combinations in restraint of trade. It is lawful to enlarge a corporation by a merger if the united concerns were not in competition or if monopoly is not yet imminent.

This gap in the law is responsible for much of the weakness which has already been noted in the application of Section 7 of the Clayton Act. Since acquisition of corporate assets is not forbidden in this statute, mergers can be organized with impunity provided stock is not acquired as an intermediate step. Moreover, after the judicial decisions which have been summarized above, stock acquisitions became feasible as intermediates in executing mergers. Since 1914 the merger device has become common as a means of uniting competing corporations. The Federal Trade Commission found that mergers or acquisition of physical assets had been used in about 65 per cent of 1,100

cases of corporate consolidation which the commission examined.[80]

Since 1930 the FTC has repeatedly recommended that Section 7 of the Clayton Act be amended to prohibit acquisition of assets as well as stock.[81] This recommendation is less ambitious than that which is offered above, for its purpose is to attack the monopoly problem without reference to the problem of gianthood. Nevertheless, to close this hole in the law of monopoly would be a useful step toward a more effective policy.

Measures to Preserve the Impartiality of Credit Institutions

A third type of environmental change which is important is modification of banking laws to prevent interlocks of interest between nonfinancial corporations and commercial and investment banks. The basic purpose should be to prevent credit institutions from being so closely identified with some of their customers as to give the latter a preferential status. To this end, the security holdings of such financial institutions in particular companies should not exceed a relatively small percentage of the total securities issued by these companies,[82] and the officers and directors of such financial institutions should be excluded from the offices, and from any substantial participation in the directorates, of nonfinancial institutions. The purposes underlying these rules and the techniques of their application are similar to those which, under the general corporation law, should be applied to ordinary corporate interlocks, except that, no matter how rigid may be the limitations imposed upon ordinary corporations, sufficient leeway

[80] *Report and Comment* of the Federal Trade Commission on HR. 2357, 79th Congress, 1st Session, p. 15.

[81] See the annual reports of the commission. See also TNEC *Hearings,* Part 5, pp. 1772*ff.* Various bills have been introduced in Congress in accord with the commission's recommendation. Most recent are bills by Representative Estes Kefauver, which the commission has approved. On June 5, 1947, the Judiciary Committee of the House of Representatives decided to report favorably an amended bill, HR. 3736, based upon Mr. Kefauver's latest bill, HR. 515.

[82] Such a limitation is now regarded as good financial practice but is not mandatory. In the Japanese economy, banks which violated this principle became focal points of economic concentration. See U.S. Department of State, *op. cit.,* Part I, Chap. III.

In HR. 3351 (80th Congress, 1st Session) a pending proposal would limit the fusion of banking interests with the interests of other commercial enterprises by forbidding bank holding companies to own voting stock of nonbanking enterprises.

should be provided to enable banks to invest in securities, to manage securities in trust accounts, and to take over the collateral of defaulted loans.

To prevent identity of interests between banks and particular customers, an additional limitation is necessary. When a large part of a bank's assets consists of the obligations of a single large borrower, there is a common interest among the two concerns whether or not there is a common ownership or management. As a precaution against communities of interest built upon such a foundation, banks should be prevented from extending loans to one borrower in excess of a modest proportion of their total capital.[83]

Measures to Prevent Excessive Expansion by Reinvestment of Earnings

The program set forth above is designed to do no more than prevent giant corporations from being created by the union of lesser corporations. In itself it would not prevent incremental growth of the power of great enterprises through direct investment of new funds.

An appreciable part of the expansion of great enterprises now takes place without recourse to the capital markets.[84] Where concerns issue new securities to finance their growth, they must compete for capital with other enterprises big and little. This competition checks their growth in so far as other concerns can offer better prospects of profit. It imposes a rough and imperfect competitive test upon the expansion program. But when expansion is financed by reinvestment of corporate profits and establishment of excessive corporate reserves, the money that is spent in growing bigger never passes beyond the control of the management which attains greater power by reinvesting it. No independent discretion is exercised in deciding whether the corporation shall be enlarged. Thus a concern that has enough bargaining power to obtain large profits enjoys a preferential status in increasing its size and bargaining power still further. The process appears to be a cumulative one through which the control of the nation's investment funds becomes increasingly concentrated. This type of expan-

[83] Federal banking law now prevents loans to a single borrower in excess of 10 per cent of the capital and surplus of the lender. Information is not available to show whether or not this limitation is sufficiently tight.

[84] While this book was in press, recent estimates were published in *The Federal Reserve Bulletin* for June, 1948, pp. 615-631. According to these, in 1947 internal sources supplied 56 per cent of corporate funds.

sion is dangerous in a sense quite different from ordinary growth through security flotations.

Ways should be found to discourage excessive expansion by reinvestment of corporate earnings. This means that ways should be found to prevent large enterprises from accumulating reserves substantially in excess of what is appropriate to the contingencies for which these reserves are ostensibly intended, and that incentives should be found to induce large corporations to pay out most of their profits to their owners, who are likely to spend and invest the funds in various directions. Taxation upon retained corporate earnings has already been used as a device to prevent evasion of income taxes. In the case of corporations above a generous minimum size, it might be used also to force managements to rely for expansion more upon the capital market and less upon earnings. By treating excessive additions to reserves as earnings, such taxes could also be used to limit the opportunity to expand by accumulating unneeded reserve funds.[85] In measures of this kind, it would be appropriate to leave a generous leeway for variations in corporate practice and to exempt small enterprises altogether. The limitations should be applied cautiously, for it is important not to destroy the desire of managers of large enterprises to get more customers and sell more goods. What is needed is merely a precaution designed to prevent sustained growth, without recourse to the capital market, on a scale sufficient to destroy the purposes of the competitive policy.

In so far as reinvestment of earnings is now used merely to expand the holdings of large corporations in unrelated fields, such a program should cause no great difficulty. For example, during and after the First World War the Du Pont company used a large part of its wartime earnings to acquire the largest single holding of stock in the General Motors Corporation, and the connection between these two companies has given Du Pont a preferential position in the manufacture of automobile lacquers and similar commodities. The power of the Du Pont company would have been more limited and no public interest would have suffered if Du Pont's profits had been paid to its individual stockholders and invested by these persons either in General Motors stock or in other assets as they saw fit.

[85] The severity of such a policy might reasonably be made to vary with the size of the concern, perhaps by graduating the rate of tax in proportion to the absolute amount of earnings retained.

However, objection will be raised that inability to reinvest savings freely may prevent certain enterprises from undertaking important projects designed to enhance their own efficiency but not yet understood to be feasible and important by the investing public at large. Liberty to make sure that important new projects are undertaken could be reserved to any management by various devices. For example, an enterprise might be permitted to avoid tax on reinvested earnings in any case in which the new investment was separately incorporated and the securities of the new corporation were sold to nonaffiliated interests within a limited period. In preserving competition, the important thing is, not to prevent managements from substituting their judgments for those of investors, but merely to make sure that there is no continuous accretion of power to a few managements by virtue of their mere determination and opportunity to enhance their power.

Measures to Prevent Excessive Concentration of Personal Wealth

The policies discussed above are directed toward keeping corporations from becoming excessively large and from pooling their resources. If means can be found to offset the peculiar opportunities for concentration of power which inhere in the corporate device, the problem of concentration will have been much reduced in scope. Nevertheless, corporations may be merely legal façades for individuals and families. It is possible for a great family fortune to become the basis of an undue concentration of economic power or of monopolistic control over a particular industry in spite of public precautions to maintain the nominal independence of the various companies which that fortune controls.[86] A complete system of safeguards against undue concentration would necessarily include devices to limit the scope and power of such fortunes.

This part of the problem is less important today than it has historically been. Use of the income tax with suitably graduated surtaxes as a principal source of government revenue has made accumulation of personal fortunes more difficult than formerly, and the graduated

[86] The Du Pont companies, for example, are controlled through a family holding company, which presumably is not indispensable to continuance of the control. The Mellon companies are said to be closely held by the Mellon family and its friends. Of eight prominent interest groups in the American economy, at least three appear to have originated in a large family fortune. See National Resources Committee, *op. cit.*, Part I, Appendix 13.

inheritance tax interposes a substantial obstacle to the transmission of great fortunes from generation to generation. One of the purposes of such tax programs has apparently been to serve as a check upon disparities of wealth. A conscious use of these devices to provide safeguards against undue concentration of power over business is the most important element of a policy designed to cope with this aspect of the problem.

Though tax policies alone may be sufficient to prevent personal fortunes from exercising power similar to that of giant corporations, it is doubtful that these policies will limit fortunes severely enough to remove the possibility of monopoly control over particular industries through personal stockholdings.[87] For this purpose, supplemental safeguards are desirable. Persons who own or control large amounts of wealth should be required to file periodic statements of their holdings, and these should be scrutinized for possible monopolistic concentrations. The law should provide that where monopolistic power is based upon personal assets the individual may be required to divest himself of appropriate parts of his property until his interests have become sufficiently diversified to remove the danger.[88]

[87] Thomas Fortune Ryan, who died in 1928, held substantial blocks of stock in apparently unrelated tobacco companies. His estate included 60,000 bearer shares in British American Tobacco Company, 157,000 shares in two issues of Liggett & Myers Tobacco Company common, 34,000 shares in P. Lorillard Company common, 105,000 shares in R. J. Reynolds Tobacco Company common B, 45,000 shares of Tobacco Products Corporation common, 7,000 ordinary and 7,000 deferred shares in Tobacco Securities Trust Co., Ltd., 83,000 shares in Union Cigar Company common, 82,000 shares in two issues by Union Tobacco Company, 17,000 shares of United States Tobacco Company common. In addition, Mr. Ryan's personal holding company, the North Virginia Corporation, held 755,000 registered ordinary shares of British American Tobacco Company, 207,000 registered ordinary shares of Imperial Tobacco Company of Great Britain and Ireland, and 91,000 ordinary and an equal number of preferred shares of Tobacco Securities Trust Company, Ltd. See *The New York Times*, Feb. 16, 1932.

[88] This proposal might encounter difficulties of constitutionality; the present act, as interpreted in the dicta of the Northern Securities decision, does not permit divestitures of individual stock holdings. Mr. Justice Brewer in a concurring opinion in that case (*Northern Securities Co. v. United States*, 193 U.S. 361) said in part: "Further, the general language of the act is also limited by the power which each individual has to manage his own property and determine the place and manner of its investment. Freedom of action in these respects is among the inalienable rights of every citizen. If, applying this thought to the present case, it appeared that Mr. Hill was the owner of a majority of the stock in the Great Northern Railway Company, he could not by any act of Congress be deprived of the right of investing his

Promotion of Small Enterprise

Efforts to reduce the opportunities for growth that are available to big business should be supplemented by measures designed to strengthen the smaller and weaker business enterprises and to increase their number. The bargaining power of large concerns may be reduced by making small ones more efficient, and the fewness of competitors may be diminished by making it easier for new small enterprises to be launched.

The simplest way to promote small enterprise is by direct subsidy. But such a policy is not commendable, for the purpose of creating competition is to relieve the community of a burden from monopoly, not to impose upon it a burden from parasitism.

Nevertheless, it is desirable to give small business some financial advantages which might be described as indirect subsidies. Modern governments render many services to business which are not equally valuable to all enterprises, and levy many taxes upon business which fall unequally. Among the services of government are some from which large enterprises can benefit more readily than small ones. Among the taxes are some that a small concern finds peculiarly difficult to bear. Care should be taken to avoid weighting the balance of government activities and of tax receipts in favor of the large enterprise against the small.[89] Instead, in business as elsewhere, the government is justified in supplying service for those groups that cannot readily serve themselves and in financing governmental activities with substantial regard to relative ability to pay. The importance of such preferences for the small concern is enhanced by the fact that avoidance of undue concentration of economic power is in itself an important public policy.

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surplus means in the purchase of stock of the Northern Pacific Railway Company, although such purchase might tend to vest in him through that ownership a control over both companies. In other words, the right, which all other citizens had, of purchasing Northern Pacific stock could not be denied to him by Congress because of his ownership of stock in the Great Northern Company." Mr. Justice Holmes' dissent agrees with Mr. Justice Brewer's reasoning in this respect (193 U.S. 409-411): "But I do not expect to hear it maintained that Mr. Morgan could be sent to prison for buying as many shares as he liked of the Great Northern and the Northern Pacific, even if he bought them both at the same time and got more than half the stock of each road. . . . I am happy to know that only a minority of my brethren adopt an interpretation of the law which in my opinion would make eternal the *bellum omnium contra omnes. . . .*"

89 See J. M. Blair, H. R. Bowen, and C. C. Fichtner, *Taxation,* Smaller War Plants Corporation, September, 1945.

In tax policy the application of this principle means that various types of taxes upon business activity or business property should include exemptions for small holdings and new ventures and should provide for progressive increases in tax rates in the higher brackets.[90] Naturally, many considerations other than maintenance of vigorous competition must enter into tax programs. So far as these considerations permit, an objective of tax policy should be to make the burden of business taxes progressive with size rather than retrogressive. But tax policy should not be relied upon to recapture monopoly profits or to overcome laxity in the enactment and administration of antimonopoly laws. Direct measures to prevent excessive accumulations of power and abuses of power are preferable. If such measures fail, mere increase in the tax outlays of monopolistic business is unlikely to destroy the monopoly, and recapture of monopoly profits will not remove the restrictive effect of the market policies from which those profits were obtained.

Provision of special governmental services for small enterprise is peculiarly desirable at points where present methods of industrial organization give the large concern an inherent advantage.[91] Individual small enterprises can seldom afford to undertake research programs or to hire the most competent managers. To them business problems which recur infrequently are likely to be unprecedented emergencies, in the handling of which they have no experience comparable to that of a larger concern. Something could be done to improve both their efficiency and their competitive success by making available to

[90] In 1937 a study by the Twentieth Century Fund suggested use of excess profits taxation to recapture monopoly profits. See Carl Shoup and others, *Facing the Tax Problem*, The Twentieth Century Fund, Inc., New York, 1937, especially pp. 276-278 and 409-411. In May, 1945, the Small Business Advisory Committee of the Department of Commerce suggested, among other proposals, that the capital stock tax be repealed, that provision be made in the income tax to carry forward business losses for longer periods, and that the exemption in the excess profits tax be increased to $25,000. See *The New York Times*, May 28, 1945. In May, 1946, Randolph Paul, executive assistant to the President of the United States, suggested to the Tax Executive Institute that small corporations with few stockholders should be given the option of reporting income as partnerships in order to avoid the double taxation of both corporate and individual income taxes. See *The New York Times*, May 16, 1946.

[91] The Senate Small Business Committee has emphasized the need for access to risk capital, opportunity to buy war-surplus goods, access to new technology, and opportunity to participate in foreign trade. See *Senate Small Business Committee—Its Record and Outlook*, Report No. 47, 79th Congress, 1st Session, pp. 14-18.

them, under public auspices, competent advice about technological and managerial problems.[92] Their technological handicap could be reduced by giving them access to publicly established research organizations prepared to do specialized research on a fee basis, and by enlarging the amount of generally useful research carried on in governmental agencies which make the results available to all.[93] Their lack of economic information could be reduced by similar public programs of research about markets and prices.[94] Comparable services are already performed by the government for farmers and for certain special industrial groups; but such industrial aids as are provided have seldom been deliberately planned as aids to small enterprise.

Government could also help small businesses find capital.[95] It is peculiarly difficult and expensive to raise small amounts of money with which to start or expand a small enterprise. Such business is unattractive to investment bankers, and alternative financial channels have not been organized. There is a similar though lesser difficulty in obtaining short-term credit, particularly if the amounts wanted, though relatively small, are somewhat too large to be supplied by local banks. Provision of suitable credit facilities for small business under government auspices might relieve this difficulty, as governmental measures have alleviated the difficulties that once surrounded farm credit and residential financing.

An unusual opportunity to promote small enterprise has been presented to the Federal government in the reconversion of war industry. Capital assets with an aggregate value of more than 16½ million dollars were owned by the government at the war's end and were available for sale to private persons. They included 1,163 plants which had

[92] See *Report of the Small Business Advisory Committee to the Secretary of Commerce*, May, 1945, pp. 10-13.

[93] See "International Exchange of Technological Information to Assist Small Manufacturers All Over the World," address by Maury Maverick, chairman, Smaller War Plants Corporation, Mar. 8, 1945.

[94] See Small Business Advisory Committee, *op. cit.*, pp. 13-16.

[95] Such aid was proposed in 1936 in a report by the Committee on Financial Aid to Small Business to the Council for Industrial Progress (Mar. 12, 1936). In 1944 Senator Taft introduced a bill (S. 1777) to establish a Small Business Finance Insurance Administration. Under the pressure of such proposals, the program of the Reconstruction Finance Corporation was extended to include participation in bank loans to industry up to 75 per cent of the value of the property, with a ceiling of $100,000. See 164 (Aug. 1, 1946), *Commercial and Financial Chronicle* 611, and *Dun's Review*, November, 1941.

cost less than $250,000 and 1,027 others which had cost less than 1 million dollars.[96] Preference for small concerns in disposing of capital assets was thought to be capable of establishing or strengthening a large variety of small enterprises in many industries. Sale of such assets to a few large corporations, on the contrary, was recognized as a means of consolidating and extending concentrated corporate power. Policies of encouraging small enterprises and of avoiding sales that would increase the dangers of monopoly were officially adopted, but were imperfectly carried out.[97] A considerable portion of the opportunity presented by the program has already been lost. But a more vigorous execution of the policy in disposing of the assets still in government hands could still strengthen small enterprise.

Action on behalf of small enterprises should be kept consistent with the broad purposes to preserve competition and to encourage efficiency. It would be possible to rescue particular groups of small enterprises by guaranteeing them satisfactory prices, by assisting them in erecting barriers against competitors who invade their market from outside, or by granting them some other form of monopolistic privilege. Since the purpose of a policy that favors small enterprises is to preserve competition, it obviously would be nonsensical to surrender essential elements of competition in the process of favoring them. No form of favoritism for little business should be accepted which deprives businessmen of the opportunity to compete or which clearly makes the performance of the industry less satisfactory from the point of view of the consumer.

At best a program to strengthen small enterprise must be general in its application. It may create a more favorable environment for small concerns and thus contribute to their well-being throughout the industrial system. It cannot assure their success within each particular industry. Indeed, in many cases an improvement in the position of small enterprises at one stage of production or distribution may worsen their position at another stage. For example, in some industries large manufacturers sell through small distributors and vice versa, so that the success of the small producer is advantageous to the large distributor. Because of such complicated relationships as these, a program to promote small enterprises cannot take the place of direct measures to reduce the size and power of large concerns, even if this

96 See Senate Small Business Committee, *op. cit.*, p. 15.
97 *Ibid.*, p. 16.

program should achieve the maximum success of which it is theoretically capable.

SUMMARY

If the policy that has been outlined in this chapter were to be systematically applied to American industry, it would require a substantial reduction in the number and size of large enterprises. There would be little interference with concentrated control over single products, both because such control is seldom seriously restrictive and because it often rests upon the operation of a single large plant which could not be disrupted without waste. Most concerns that dominate a whole industry would be substantially reduced in size by dissolution or divestiture; but there would be certain awkward cases in which concentration of power would have to be tolerated or efficiency reduced or regulation invoked. (Moreover, since buyers need not be very large in order to purchase all the output of a small seller or to threaten to produce for themselves, bargaining advantages which the large buyer derives from such tactics would persist.) Giant conglomerate enterprises operating in unrelated industries would be systematically dissolved into smaller, more coherent undertakings except where they could demonstrate their usefulness.

The effect upon the future growth of business units would be equally striking. Concerns engaged in related types of activity would be prevented from uniting, both by direct prohibition of stock purchases, interlocks of personnel, and mergers among competitors, and by a general rule against the union of corporations which thereby acquire the ability to control an industry or coerce competitors, or which thereby unduly reduce the number of policy-making units in an industry. However, in particular cases in which corporate mergers would increase productive efficiency, permission to unite might be given under appropriate public regulation. Concerns engaged in unrelated activities would be prevented from uniting in all cases in which their union would produce an enterprise of large size unless they could refute the presumption that the result of this size would be coercive power or a preferential position in the economy.

Excessive size achieved by the mere expansion of a single enterprise would be more difficult to prevent. True, incentive taxation designed to discourage retention of corporate income could be used to induce large business enterprises to have recourse to the capital market more frequently than they now have. But it would not be feasible nor de-

sirable to forbid expansion of a concern's operations by use of its own receipts when the enlarged activity merely responded to an active demand. Similarly, it would not be feasible nor desirable to forbid expansion with funds derived from new security flotations. To build a new plant, employ more men, and sell more goods is an expression of healthy competitive success, with which public authority must hesitate to interfere lest the incentive derived from the search for more business be destroyed. Hence expansion by an enterprise would be permitted up to the point of imminent monopoly or excessive over-all size, and such action as might be taken in extreme cases would be remedial rather than preventative.

But, though little could be done to prevent expansion by single enterprises, this type of growth would not be a substantial threat to the maintenance of competition. Few if any of the enterprises that are now large enough to constitute a public problem have attained their present size merely by such expansion, and there is no reason to believe that there will be many such in the future.

In a thorough attack upon excessive concentration, dissolution and divestiture would be the principal means of action at the outset in an effort to recover lost ground by clearing away existing concentrations of power. A broad use of such devices is a formidable undertaking. Remedial action is costly because there is some temporary waste associated with the reorganization of a going concern and because it entails the maximum conflict with vested interests.[98] Nevertheless, the need for such action is as real as the abuses that spring from concentrated power. But even if the destruction of existing concentrations were to be incomplete or sporadic, the principal purpose of an attack upon concentration could still be achieved. The techniques of prevention would be more important than those of cure. As the economy grows in total size, and as technological research and improved means of transportation and communication break down the boundaries of existing markets, the significance of an enterprise of a given size is reduced. Existing concentrations of economic power are likely to become less important if they can be prevented from growing larger. Hence the primary emphasis should be upon means to prevent future

[98] Nevertheless, it is noteworthy that legal requirements for dissolution of public-utility holding companies have been applied with less dislocation than the companies originally predicted, and that the market prices of the divided securities indicate that in business terms the reorganizations were successful.

growth. After the initial dissolutions and divestitures had been completed, similar action would be needed only sporadically to cope with the results of mistakes or of neglect in the preventative program or to repress monopolies derived from the gradual expansion of a single enterprise.

V. COERCIVE AND EXPLOITATIVE BEHAVIOR

THE PREVIOUS CHAPTER has made it apparent that for technological and administrative reasons, if for no others, significant degrees of power derived from bigness must sometimes be tolerated. Moreover, since the correction of excessive size is difficult and will often necessarily be slow, delays and partial failures in accomplishing the program are likely to make the residual problem larger than need be. Therefore, public policy should include, so far as possible, checks upon the more obvious forms of abuse of preponderant commercial power. Such a second line of defense is desirable as a precaution regardless of the degree of optimism with which one undertakes the attack upon size. Moreover, a program directed against monopolistic behavior is needed to prevent sporadic abuses otherwise uncontrollable.

But although such safeguards are desirable, the possibility of devising them is very limited. An adequate program would necessarily involve surveillance over business behavior, discrimination between acceptable and objectionable behavior, and efforts to curb the latter. To define objectionable behavior in explicit terms without regard to the surrounding circumstances is difficult and in some fields impossible. In so far as such definitions are vague or ambiguous there is danger that the repressive surveillance exercised by government will impair incentives for vigorous competitive action by large enterprises. This danger is particularly great wherever the behavior to be repressed takes the form of price reductions or other activities similar to those of normal competition.

Nothing would be gained by using the power of government to deprive large enterprises of a venturesome spirit or to induce them to compete halfheartedly, with a regard for the interests of their competitors similar to that which is produced by collusive agreements. This would be to require semimonopolistic concerns to behave like monopolies. In so far as the power of large enterprises cannot be reduced by direct attacks upon their size, it would be preferable to take some risks that they will coerce their competitors and exploit their cus-

tomers rather than to deprive them by regulation of whatever competitive impulses they still retain.

Nevertheless, it is possible to identify and prevent certain types of coercive and exploitative action. The purpose of the following pages is to examine the forms of objectionable use of power which are most often encountered, in order to indicate the extent to which repressive legislation is feasible, the caution that must be used in endeavoring to cope with such behavior by direct control, and the limitations that must be accepted in such an attempt.

Objectionable uses of the power of great enterprises may be roughly classified into the coercive and the exploitative. The first includes attempts to coerce or destroy competitors. The second includes price raising, reduction of quality, and other policies designed to afford monopoly profits at the expense of consumers. The simplest form of attack upon such policies would be an attempt to define them by law and to prohibit them through legal proceedings like those used generally under the antitrust laws. Such a program would be desirable if it could cope with the cruder and more prevalent abuses of power, even though it might not destroy all forms of differential advantage over competitors and customers nor deprive large enterprises of all forms of disciplinary influence over their fellows.

COERCIVE ACTIVITIES

The coercive activities of large enterprises—that is, those that are designed to destroy competitors or to discipline them through fear—are probably easier to define than the exploitative activities. The possibilities of direct repression of coercive policies may be examined by considering the coercive situations which are most obvious, most clearly identifiable, and most frequent. Outstanding among these situations are the following.

Preemption of Facilities Which Are Necessary to Competitors

A large concern sometimes disciplines or destroys its competitors by buying most of the visible supply of facilities which are necessary to survival in the industry. Purchases should not be described as preemptive when they are limited to the reasonable needs of the large buyer, even though independent users suffer from a resulting scarcity. The preemptive policy consists in buying more than one needs in order

to take supplies off the market or to become the source of supply for one's competitors. This policy is most effective if the facilities needed are irreplaceable, as are some territorial sites, such as docks and waterfalls. However, by preemptive bidding even produced raw materials or labor may be bid up to prices higher than the independent concern can safely pay. Such efforts to deprive rivals of supplies are particularly effective if the materials and working skills used by these rivals are distinctive in some respect and are relatively limited in supply.[1]

Preemption may also take the form of preferential or exclusive alliances with concerns that render essential business services. Distributors may be bound to the large concern by exclusive-dealing contracts or by threats that they will suffer an insupportable discrimination if they handle the goods of smaller rivals.[2] Pressure from large borrowers and depositors may induce banks to withhold credit from small competitors of the large concern when the policies of these small competitors are regarded as inconvenient. Groups of large concerns may exchange technology and patent rights to the exclusion of smaller enterprises.

[1] For example, the major cigarette manufacturers systematically bought the qualities of tobacco used by manufacturers of 10-cent cigarettes and thereby destroyed the differential in price between the tobacco which was their own raw material and that which was used for the 10-cent brands. See *The American Tobacco Company et al. v. United States,* 328 U.S. 781 (1946). Similarly, the Aluminum Company of America entered into certain contracts for electric power which restricted the suppliers from furnishing electricity to others for use in producing aluminum; it has also been accused of preemptive acquisition of bauxite deposits and water-power sites. See *United States v. Aluminum Company of America,* 148 F. (2d) 416 (1945). See also George W. Stocking and Myron W. Watkins, *Cartels in Action,* pp. 224-225, The Twentieth Century Fund, Inc., New York, 1946.

[2] In an early antitrust case it was established that the International Harvester Company restricted competition by exclusive contracts with all the dealers in many rural localities. A consent decree in 1918 limited the company to a single sales representative or distributor in any one town. See *United States v. International Harvester Company,* 214 F. 987. The major oil companies have sometimes allowed a discount of ½ cent per gallon upon gasoline distributed by filling stations that agreed to handle no other company's products. The effect of such discounts by the majors, it is alleged, has been to deprive independent producers of the opportunity to use many of the filling stations and to exclude these producers from many markets where their volume was not sufficient to support filling stations of their own. See complaint filed in *United States v. American Petroleum Institute et al.,* District of Columbia, Sept. 30, 1940, par. 41, 43. See also complaint filed in *United States v. Standard Oil Company of California and Standard Stations, Inc.,* Southern District of California, Central Division, Jan. 2, 1947, par. 27-33. While this book was being published, the district court decided this case in favor of the government.

Where such practices are well defined and important, they are often aspects of an effort to create or consolidate a monopoly and hence are illegal under the Sherman Act. In some instances they express the agreed policy of several different concerns and therefore may be prosecuted as combinations in restraint of trade. Although the existing law may miss sporadic and tentative preemptive maneuvers, it is questionable whether new general legislation would be any more effective. Nevertheless, in the codification of objectionable practices which has already been suggested, it would be desirable to include provisions specifically forbidding the purchase or holding of unneeded supplies, resources, or facilities for the purpose of withholding them from others, and forbidding use of pressure or agreements to prevent a business enterprise from dealing with any other business enterprise.

Discriminatory Sharpshooting

A large and diversified enterprise enjoys an unusually good opportunity to destroy a smaller and less diversified rival by localized price cutting. When the large concern serves many territorial markets, it can select local competitors for destruction, reduce its prices in their local markets, and maintain its financial solvency from its sales at higher prices elsewhere. The small concern which relies exclusively upon a single local market is helpless against these tactics and may be disciplined or driven into bankruptcy at the discretion of its larger rival. Similarly, an enterprise that sells a wide variety of commodities may select as its victim a concern that specializes in the sale of one or a few of these commodities, and may with impunity undertake a similar program of price cutting limited to the items sold by the specialized concern. In its crudest form such an attack may be pushed so far as to destroy one concern after another and thus to enlarge the attacking enterprise. Less crudely, however, the power to make such localized attacks may be used as a disciplinary device to induce the small concerns to adopt policies that the larger and more diversified enterprise regards as satisfactory. In this form the program is unlikely to require many instances of localized price cutting or to require that these cuts be very deep or very long sustained. The mere power to undertake such a program is sufficient to lend authority to the large enterprise and to persuade the small one that a conciliatory policy is wise.

Large buyers may also succeed in strengthening themselves by obtaining discriminatory price concessions upon what they buy. Taking advantage of their ability to start producing for themselves and of the importance of their large purchases to their suppliers, they are often able to obtain goods more cheaply than their small competitors.[3] Their bargaining power becomes the basis of lower purchase prices. In turn, the lower cost of what they buy enables them to reduce their sales prices without reducing their operating margins or else to spend more than their rivals upon productive and selling activities. Thus price differentials at one stage of the marketing process establish a handicap for competitors at the next stage. Concerns that enjoy the lower prices are likely to grow in size and financial strength, thus attain still greater bargaining power, and thereby further enhance their ability to buy at advantageous prices. Concerns that must pay more may come to exist only by the forbearance of their larger rivals.[4]

In some cases the ability of the large buyer to obtain price reductions is enhanced by the fact that the seller incurs less expense in serving him than in serving smaller buyers. A large order is likely to entail less sales expense, bookkeeping expense, packing expense, and shipping expense per unit sold. It may also entail lower manufacturing costs if any of the processes are such that the machinery has to be reset for different orders. There may also be certain economies in serving a concern that buys a large aggregate amount within a given period of time, even though it may not purchase unusually large amounts in any one transaction. Where the costs of serving the large buyer are rela-

[3] See *United States v. The New York Great Atlantic and Pacific Tea Company, Inc. et al.,* 67 F. Supp. 638-639, 645-654 (1946).

[4] In the recent A & P case the court noted several instances of this character: "In Dallas, a competitor, Clark, had a combination store one-half block from an A & P store. He testified that A & P's low prices on national brands were about 1¢ above his cost. His sales declined from $95,000 in 1938 to $75,000 in 1941, net income falling to $1,350 in 1941; in 1942 he went into receivership. . . . Clark testified that his credit losses, which amounted to one-half of 1% of his sales, were not the cause of his failure.

"Culwell, owner of a Clover-Farm store located next door to an A & P store, testified that he compared A & P's advertised prices with his own and that A & P conducted every day sales at retail prices below his cost. His sales in 1937 were $73,000, profit $4,000; his sales in 1938, $65,000, his profit $3,000; 1939 sales were $62,000, net profit $2,000; 1940, $60,000, net profit $2,000; 1941, $59,000, net profit $1,100. In June 1942 A & P moved its neighboring store fourteen blocks away. Culwell's business jumped from $59,000 in 1941 to $80,000 in 1942, net profit to $3,000." (67 F. Supp. 667.)

tively low, the atmosphere is likely to be favorable to price concessions, which may be greater or less than the seller's actual savings in the transaction.[5]

In so far as the large buyer's bargaining power merely enables him to obtain the advantage of economies inherent in the scale of his purchases, the exercise of this power is a part of the process by which more efficient methods of operation supersede less efficient ones. Even though smaller concerns may be handicapped or destroyed in the process, this result must be accepted unless efficiency is to be impaired. But in so far as price reductions to the large buyer cannot be justified by economies, they constitute one of the means by which the bargaining power of the great enterprise is cumulatively enhanced without good excuse and probably to the public detriment. If discriminatory price reductions not based upon relative costs can be prevented or punished, operation on a scale large enough to afford an opportunity to discriminate is likely to lose much of its coercive influence. Hence there is a strong argument for measures to outlaw such forms of price discrimination and sharpshooting forms of price competition.

Nevertheless, such measures present practical difficulties and substantive dangers. To distinguish between acceptable and objectionable price variations by a comparison of costs is to impose great burdens upon one of the newest and weakest fields of cost accounting. In selling to different customers, few costs are clearly segregable, and the allocation of the rest is determined by policy decisions which masquerade as mere accounting procedures. Unless a canon of good accounting is established, there is no basis for defining the objectionable price discrimination. But to adopt such a canon may be to assert that there is only one proper method of allocation where several plausible ones can usually be perceived.

Moreover, the insistence that prices may vary only with differences

[5] Prior to the passage of the Robinson-Patman Act, little information was available about the relative costs of selling to different types of customers. Price concessions were often made upon the excuse of economies in sale but were seldom based upon an analysis of these economies. Since the act was passed, large customers and their suppliers have undertaken extensive study of distribution costs in an effort to justify price concessions under the law. Such studies have frequently shown that whereas quantity discounts become progressively greater upon larger and larger purchases, the economies associated with a larger purchase are substantial as between relatively small quantities, but soon become negligible as the quantities increase. Such findings support the view that savings have constituted the justification rather than the reason for price differentials.

in cost points toward acceptance of the general principle that prices should be based upon costs and should not go below costs. In ignoring the significance of variations in demand from place to place and from time to time, this principle has repeatedly proved insufficient for a sound price policy.[6]

It is difficult to prevent discriminatory price reductions without unduly impairing the entire process of price competition. Reduction of prices is both one of the chief symptoms of competition and one of the foremost objectives of a competitive policy. Any concern that reduces prices probably does so principally in the hope of taking some business away from competitors. Often, however, the competitive incentive is to experiment with price reductions of limited scope rather than with general ones. Conditions of cost, of market demand, and of competitive rivalry which are encountered in the sale of different commodities, or in the sale of the same commodity in different territorial markets, are likely to be so various as to invite a policy of price differentiation. The likelihood of price variations becomes all the greater in so far as enterprises adopt a general policy of charging what the traffic will bear; for under such a policy some sales are likely to be highly profitable, while others are made for any price that more than covers direct expenses. Moreover, it may be discreet for an enterprise that is contemplating a general adjustment of prices to experiment with it at certain points before adopting it generally. Local price reductions and price reductions upon particular commodities selected from one's line of products are therefore to be expected, even though the concern instituting them is not cracking the whip over its competitors.[7]

[6] Promotional pricing based upon demand rather than upon uniform cost principles has often been approved by public-utility commissions as consistent with sound public policy. Distress pricing below cost is a commonplace in close-out sales, sales in bankruptcy, and the like. The weakness of the cost basis for price was exhaustively demonstrated by the experience of NRA. See, for example, H. F. Taggart, *Minimum Prices under the NRA,* Michigan Business Studies, Vol. VII, No. 3, University of Michigan Press, Ann Arbor, 1936, and Saul Nelson, *Minimum Price Regulation under Codes of Fair Competition,* NRA Division of Review, Work Materials, No. 56, March, 1936.

[7] The complexity of this problem is illustrated by the example of a chain store that was accused several years ago of having inaugurated in a Middle Western city a program of local price cutting upon meat, designed to destroy the independent butchers of that city. Investigation showed that for each important kind of meat sold the chain had adopted a price equal to the lowest price upon that item that was to be found elsewhere in the city. Each independent butcher had certain cuts of meat which he used as leaders or which he was offering at low prices in order

Similarly, the effort to buy as cheaply as possible is an essential feature of competition; and except in a perfect market it is not to be expected that all buyers will obtain their supplies at the same prices. It is to be expected that buyers will try to find inducements to persuade sellers to reduce prices, and that some buyers will be more successful than others. Such considerations appear to require a choice between substantial limitation of business freedom to reduce prices and acceptance of sharpshooting forms of price competition.

One way to prevent sharpshooting is to forbid variations in price policy within a particular concern. Various state governments have adopted laws that prohibit price discrimination by a concern in different markets within the state. These laws illustrate the geographic aspects of such a policy. To carry out the policy fully, it would also be necessary (1) to prevent the sale of so-called "leaders" and by-products; that is, to require a concern to follow uniform principles of price determination in pricing the various commodities which it sells; (2) to prevent price discrimination among classes of customers; that is, to require a seller to make a single price list available to all purchasers; and (3) to prevent unreasonable discriminations among different types of transactions; that is, to prevent quantity discounts and other types of price concessions by which unreasonable advantage is given upon a type of purchase that some buyers can undertake but other buyers cannot.

The first of these three additional principles has been partially incorporated in laws that attack loss-leader selling. For the most part, these laws are based upon the presumption that the prices of different products sold by the same seller are or should be determined by the respective costs of those products. Accordingly, the laws provide price formulas which prevent the sale of any commodity below cost, as defined by the statute.

In so far as variation of prices with market demand or intensity of competition may be recognized as legitimate, the basic principle of such statutes is inadequate. In practice, various exceptions are usually incorporated in the statutes themselves. For example, vendors are left free to sell below cost to meet competition (though in some cases they are allowed to do so only if the competitive price which is met is itself

to reduce an overstock. The effects of the chain's policy were sale of nearly all the meat in the chain's stores at prices equivalent to those suitable for leaders and overstocks, and establishment of a price level much lower than that of the independent stores.

lawfully established in accord with the statute). Similarly, exceptions are made for close-outs, end-of-season sales, sales in bankruptcy, and various other circumstances under which it is clear that a cost basis for a price would be absurd.

Moreover, the reliance upon cost makes it difficult for such a statute to accomplish its ostensible purpose of preventing loss-leader sales. If cost is so defined in the law as to make generous allowance for overheads and intangibles, the statute is converted from one designed to protect competitors against coercive sharpshooting into one that fixes a generous level of prices and probably guarantees a substantial profit for many vendors. If, to avoid this result, the definition of cost is narrowly restricted, the law is likely to permit the continued use of loss-leaders. In actual experience under state loss-leader laws, extreme reductions of price upon particular items appear to have been replaced by shallower price reductions upon larger numbers of items. It is questionable whether the pressure which the large enterprise can exert is appreciably reduced by such a change.

Although some of the loss-leader statutes are general in their terms, they have been intended to govern the sale of commodities by distributors rather than by manufacturers. The prevalence of conventional markups in distribution, unaccompanied by efforts to ascertain the relative costs of distributing different commodities or to adjust markups thereto, has facilitated use of the loss-leader type of statute. The law would be much more difficult to apply to the operations of a manufacturing concern, since it would encounter not only substantial differences of productive process and of cost but also distinctions between major products and by-products. It is improbable that uniform principles of pricing can be required for the many products sold by a large diversified manufacturer.[8]

Partial efforts have also been made to prevent price discriminations among classes of customers and types of transactions. Federal law concerning price discrimination, as amended in the Robinson-Patman Act, outlaws discrimination on goods of like grade and quality where certain injurious effects are apparent.[9] Indirect forms of discrimination,

[8] It is noteworthy that even in the recent extension of the American law of price discrimination, no attempt has been made to require that all prices be based upon costs or to extend the law to cover the relationship between the prices of different commodities.

[9] The law's conception of price discrimination is narrower than the usual economic one. Thus: (1) it forbids only discriminatory differences, while permitting

through differences in services rendered by the seller to his customers and in allowances that the seller may grant for services which the customers render to him, are unlawful wherever similar services and allowances are not available to all customers upon "proportionally equal terms." [10] One special form of discrimination, payment of brokerage by the seller to the buyer or to his representative, is forbidden outright, though in ambiguous language.[11]

The parts of this law that invoke a standard of proportionality in providing services and allowances and that prohibit discriminatory brokerage are designed to eliminate these particular forms of discriminatory variation in price policy. However, the principal part of the statute, which outlaws price discriminations only when they can be proved to be injurious, does not require sellers to follow a uniform price policy toward all classes of customers or of transactions. It sanctions any form of differential pricing except where specific injury or the probability thereof can be shown.

In contrast to the effort to prevent all variations in price policy within each concern, the form of attack upon sharpshooting methods of discrimination incorporated in this part of the law consists in an

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discriminatory uniformities, that is, uniform prices in spite of differences of cost; (2) an injury must be shown, either to competition by competitors of a favored customer or to competition by competitors of the seller, before a discrimination is unlawful. This leaves open an opportunity to discriminate among noncompeting customers, except upon proof, case by case, that competitors of the seller are thereby injured; (3) sharpshooting tactics which take the form of different price policies upon different commodities remain entirely untouched by the legislation, even if such tactics injure competition.

10 This phrase is not defined in the statute. Presumably services by the seller are expected to be proportional to the buyers' volume of purchases, and payments to the buyers are expected to be proportional to the services which the buyers render.

11 The statute forbids payment of brokerage or anything in lieu thereof to any person on the other side of the transaction except "for services rendered." Court decisions have held, in effect, that brokerage services cannot be rendered by a person on the opposite side of a transaction and that therefore the exception has no meaning. [See *Biddle Purchasing Co. v. Federal Trade Commission,* 96 F. (2d) 687 (1938), *cert. denied,* 305 U.S. 634 (1938); *Oliver Bros. v. Federal Trade Commission,* 102 F. (2d) 763 (1939).] Since payments in lieu of brokerage are forbidden, question arises whether price concessions can be given to customers in recognition of the economy obtained by avoiding payment of a brokerage commission. That such concessions may be illegal has been established [see *The Great Atlantic and Pacific Tea Company Inc. v. Federal Trade Commission,* 106 F. (2d) 666, *cert. denied,* 308 U.S. 625 (1940)], but since the decision turned largely upon an obvious effort to evade the intent of the statute, the law on this point is not yet wholly clear.

effort to identify the coercive results and to forbid the methods of pricing that produce these results. Under such a procedure neither local price cutting nor price cutting on particular commodities or to particular customers need be forbidden as such. But any effort to destroy, injure, or intimidate competitors of the seller by singling out their markets for special attack is outlawed, and so is any attempt by a large buyer to obtain a decisive buying advantage over his competitors. Examination of the circumstances of particular cases is required to distinguish such efforts from other expressions of a varying price policy. Relevant considerations include the respective size and strength of the competitors, the frequency with which a similar pricing pattern recurs, and the degree to which market conditions appear to offer a valid incentive for price variation. None of these considerations alone is controlling, nor need other factors be disregarded.

Federal law concerning price discrimination is now based primarily upon this general principle. Under the Sherman Act, sharpshooting methods of price cutting are unlawful when they constitute an attempt to create a monopoly. Their illegality depends, however, on judicial interpretation, and might well be made clearer by including a specific provision against such practices in the suggested law codifying the prohibitions of collusive and other illegal practices. Cases in which the Sherman Act has been invoked against selective price cutting are rare and are concerned almost wholly with price discrimination by sellers as part of some broader program.[12]

As has already been indicated, the main provisions of the Robinson-Patman Act are based upon the principle of preventing discriminatory practices which injure competition. Price discrimination on goods of like grade and quality is forbidden where the effect may be to injure, prevent, or destroy competition, either between the concern that grants the low price and its competitors or between the beneficiaries of the low price and their competitors. Differentials which work such an injury remain lawful, however, if they are made in good faith to meet competition[13] or if they do no more than reflect differences in

[12] An early example is *Standard Oil Company of New Jersey v. United States,* 221 U.S. 1 (1910).

[13] However, in *Federal Trade Commission v. Standard Oil Company of Indiana* (Docket 4389, decided Oct. 9, 1945), the commission held that where actual injury to competition has been proved, the defense that a competitor's equally low price has been met is insufficient. Appeal from the commission's decision was pending in December, 1947, in the Seventh Circuit.

cost.[14] The act applies not only to sellers but also to buyers who knowingly induce or receive unlawful discriminations.

This part of the Robinson-Patman Act is an attempt to prevent price discriminations which injure competition without withdrawing the right to use price incentives as an encouragement for efficient methods of doing business. Its principle is thus a reasonable expression of selective attack based upon the objectionable results of particular discriminations. However, there is constant pressure to modify this principle. The act originated in proposals by business groups greatly concerned about the growing power of chain-store corporations, and was originally drafted in a form designed to prevent price concessions to the large buyer under almost any circumstances.[15] Although the Congress rejected this version, interested groups have constantly urged interpretations of the law which would modify the Congressional purpose. The concept of injury to competition is ambiguous. It may include only impairment of the effectiveness of competitive forces in the market as a whole, or also injury to competition between small numbers of competitors, or even injury to a particular competitor through lack of complete equality among competitors in particular small groups of transactions. The first interpretation leaves room for considerable price variation, even though particular enterprises suffer thereby. The latter interpretations make any price variation legally hazardous unless it is based upon a difference in cost. Organized groups of distributors constantly urge the latter interpretations because they go furthest to limit the advantage obtainable by the large buyer. In so far as these views are adopted, variations in costs set the limit of safety for price variations, and there is a powerful inducement for each concern to base its prices upon a uniformly applied cost formula.

The principal danger in an interpretation based upon injury to a particular competitor lies in the fact that in industries in which concerns are relatively few and large, competition often takes the form of secret price concessions, which are likely to be discriminatory in character; and the effort to stamp out competition often consists primarily

[14] In order to distinguish beween bargaining advantage and economy, the Congress made it clear in debates upon the bill that none of the economies attributable to an increase in the total volume sold may be allocated to any special group of customers, but that instead all economies so allocated must be due to peculiarities in the transactions upon which low prices are enjoyed.

[15] See *Hearings* on HR. 8442, HR. 4995, HR. 5062, 74th Congress, 1st Session, July 10, 11, 17-19, 1935.

in attempts to require uniform methods of pricing. Congress probably never contemplated an interpretation of the Robinson-Patman Act under which the only important method by which enterprises in an industry actually compete might be interpreted as an injury to competition; but various industries have adopted such interpretations in their own thinking and have urged them upon the FTC. Thus the law of price discrimination strikes at some of the methods by which a large concern develops monopoly power, but it may be so interpreted as to encourage some of the methods by which groups of large concerns give force to collusive arrangements. Indeed, the former general counsel of NRA wrote in 1937 that "henceforth price may be used as a weapon in competition only with the greatest circumspection." [16]

To avoid this result, injury to competition should be defined as injury to the vitality of competition in the market, not as injury to competition between particular designated competitors nor as injury to a particular competitor, even though the power of large buyers is somewhat less drastically reduced by such an interpretation. The reports of the Congressional committees on the bill which became the Robinson-Patman Act indicated that the intent of the present law may be to invoke the narrower concept of injury. In reporting on S. 3154 the Senate Committee on the Judiciary said of the bill's language about effects on competition: "This clause represents a recommended addition to the bill as referred to your committee. It tends to exclude from the bill otherwise harmless violations of its letter, but accomplishes a substantial broadening of a similar clause now contained in section 2 of the Clayton Act. The latter has in practice been too restrictive, in requiring a showing of general injury to competitive conditions in the line of commerce concerned; whereas the more immediately important concern is in injury to the competitor victimized by the discrimination. Only through such injuries, in fact, can the larger general injury result, and to catch the weed in the seed will keep it from coming to flower."

The other portions of the Robinson-Patman Act cannot be justified as efforts to reconcile efficiency with curbs upon excessive bargaining power. Services rendered by the seller to his customers and payment for services rendered by customers to the seller are prohibited unless they are proportionally available to all, regardless of the relative efficacy and the relative cost of different amounts of service, regardless of

[16] Blackwell Smith, "The Patman Act in Practice," 35 *Michigan Law Review* 731.

the ability of different types of customers to use or render similar services, and regardless of the degree of injury that may be worked by a lack of proportionality. Similarly, as the law has been interpreted, the seller may be forbidden to pass on to the buyer savings that may result from the elimination of brokerage services in making the sale.[17] The provisions that depend upon proportionality ignore considerations of efficiency. The provision about brokerage runs directly counter to the cost principle. By eliminating the opportunity for sellers who do not use brokers to offer buying inducements, it goes far to give such brokers a legally supported monopoly of distribution in the lines in which they are already well established. These provisions are anomalies and should be amended to bring them into harmony with the principle of the rest of the statute.

Within the broad policy of the antitrust laws, the function of the law against price discrimination is essentially palliative. It cannot remove the difficulties that have been created by fewness and large size. That is a task requiring other instruments. Those enforcing the law can only hope to prevent price maneuvers from being used to make further large inroads upon the remaining competition. They should curb the power of large buyers where they can, but they may find it necessary to tolerate some use of that power where there is no other way to prevent consolidation of the power of large sellers.

Predatory Price War

Although the opportunity to destroy a rival by deliberate price cutting is greatest when the price cutter is so large that a considerable part of his business lies outside the field in which the rival operates, such a relationship is not indispensable. An enterprise that has strong financial resources is sometimes able to crush weaker concerns by price cutting, even though the proportion of its total sales affected by the price reduction is as large as that of sales by its victims. The threat to do so may be coercive, and the knowledge that a particular enterprise has the power to do so may give that enterprise a position of unquestioned leadership.[18]

[17] See footnote 11, p. 165.

[18] In private conversation with the author, a producer in a building material industry before the recent war called attention to the fact that one company maintained a cash reserve of well over 10 million dollars. This reserve was described as "the war chest," and it was suggested that the company stood ready to use this re-

To prevent tactics of this kind by specific enactment is hopeless. A concern cannot well be prevented from attaining a strong financial position, and the price reductions by which such a position can be converted into a coercive weapon may not be even discriminatory. To deny a large concern or a concern with ample resources the right to initiate price reductions would be to impose upon such an enterprise a duty to behave in a monopolistic rather than a competitive fashion. To deny it the right to sell below cost would be to require of it tactics of price maintenance inconsistent with the competitive behavior that is desirable at times when there is an excessive supply to be sold.

In so far as this problem cannot be met by reducing disparities in the size of different enterprises, the only promising measure with which to attack it is a general rule against efforts to create monopoly by destruction of competitors. Such a rule permits an examination of the facts as to predatory price cutting case by case, in the light of the surrounding circumstances. Recurrent use of such tactics, resulting in destruction of a series of rival concerns or in disappearance of individual business initiative on the part of such concerns, becomes ground for remedial intervention. But a pattern of predatory price cutting can be distinguished from an ordinary pattern of price competition only when the predatory cuts are substantial and sustained. While the creation of monopoly by this means may be prevented, acquisition of authority over competitors by use of price cutting as a disciplinary weapon is likely to succeed. Public policy can, however, make such tactics somewhat more difficult by making it hazardous to threaten competitors with disciplinary price cuts or to carry price cutting so far as to jeopardize the existence of the competing concerns.

Even where evidence is sufficient to establish the fact of predatory price cutting, it is difficult to devise a suitable remedy. There is little point in a mere injunction to obey the law by abstaining from predatory price cuts in the future, for the instruction would not be clearer nor more specific than the law itself. Reorganization of the predatory enterprise to diminish its size might be appropriate in some cases in spite of the relatively drastic character of the remedy and the dubious nature of the evidence of the offense. In other cases, however, bigness might not be properly subject to attack, for the technical characteristics

serve to reduce the price of its products to one-fifth of the current level at any time when price cutting by other members of the industry brought prices below levels which the company regarded as satisfactory.

of the industry might make the dissolution of the large enterprise impracticable. Thus it is probable that in many cases nothing more can be done than to punish the offender for his past actions and stand ready to punish him again if they are repeated. The extent to which punishment can be a deterrent depends, of course, upon its certainty and its severity.

In so far as the direct attack upon size leaves residual disparities of power, it is probable, therefore, that we must reconcile ourselves to residual problems of predatory price cutting and of undue influence over competitors derived from the possibility of using such tactics. The Sherman Act can set limits to the scope of such problems but cannot entirely destroy them. To define predatory price cutting as illegal in a codifying statute would do nothing to remove the inherent difficulties which have already been discussed; and if any such definition were undertaken, great care would be needed to prevent the more detailed law from reducing instead of increasing the competitive character of the pricing process.

Squeezing the Nonintegrated Concern

An enterprise that is vertically integrated may engage in several successive steps of production and distribution between its original purchase of materials and its eventual sale of products. The values which it assigns to its product at each stage of its own integrated process are arbitrary and have no direct effect upon the amount of profit that is derived from the process as a whole. To the nonintegrated concern, however, the spread in prices between successive stages of the productive and distributive process is crucial, since this difference determines the operating margin from which costs and profits are obtained. Chapter IV has already indicated that wherever a vertically integrated concern has so large a control of one of the successive steps in production or distribution that its products or services are sold to its nonintegrated competitors, this difference in strategic position readily becomes the basis for a squeeze. As much as possible of the total price-spread of the integrated process can be assigned to the particular product or service which the competitors buy, and as little as possible to other stages in production and distribution. Similarly, when a vertically integrated enterprise buys from its competitors, it can squeeze them by assigning as little as possible of the total price-spread to the pur-

chased product or service. The effect of such practices is to give the integrated concern a substantial advantage.

Two illustrations are readily at hand. Before 1939 the Aluminum Company of America was the only producer of aluminum ingot in the United States, but not the only manufacturer of aluminum products. Most of its profits were derived from ingot manufacture. High ingot prices raised the cost of raw material to concerns that competed with the Aluminum Company in the fabrication of aluminum products. A small differential between ingot prices and prices of fabricated products reduced the operating margins of these competitors. Since the price of ingot lay wholly within the control of the Aluminum Company, and the company's competition was sufficient to drive down the price of fabricated products, the size of the operating margin lay within its control.[19] Independent fabricators existed at its discretion. In its own operating statements, the allocation of prices and profits between ingot manufacture and subsequent fabrication was unimportant.

The major oil companies are engaged in the extraction and shipment of crude oil and in the subsequent refining and distribution of petroleum products. They own substantially all of the pipe lines, which are by far the cheapest means of shipping crude oil and gasoline from producing areas to markets. Independent oil producers and refiners must use these pipe lines for their products or incur the substantially higher costs of shipping by other methods. By keeping pipeline charges high, the integrated companies obtain for transportation services as much as possible of the sales revenue of the independents. They also transfer some of their own profits from their operating to their transportation activities, but this is a matter of no importance to them. Since, after deducting the high profit on transportation, their transportation cost is appreciably lower than that of the independent,

[19] In *Bausch Machine Tool Company v. Aluminum Company of America* [72 F. (2d) 236 (1934), and 79 F. (2d) 217 (1935)] the appellant, a competitor of Alcoa in the manufacture of aluminum alloys, charged that Alcoa was attempting to monopolize commerce in aluminum alloys by keeping unreasonably high the price of aluminum ingots and unreasonably reducing the price of aluminum alloys, so that independent competitors could make no profit.

The case was tried twice, with one decision for the defendant and one for the plaintiff. Each decision was reversed on appeal, and the case was then settled out of court.

they have a competitive advantage over him wherever they wish to discipline him by price reductions or otherwise.[20]

Although the squeeze is most conspicuous in creating price advantages for the vertically integrated enterprise, it is also important in assuring such a concern better service. The integrated concern can give itself preference in quality of product, speed of service, and regularity of supply in time of shortage. Where it controls the ultimate distribution of the commodity, it can direct its sales effort to assure its own products an advantage.[21]

The opportunity to squeeze competitors springs from two structural characteristics of vertically integrated enterprises. To enjoy it, such an enterprise must control a substantially larger portion of the total resources at one stage of the integrated process than is necessary to supply its own needs. It must also control so much of the total resources at this stage that other sources of supply are not adequate to serve nonintegrated concerns.

The program for limiting size which has already been discussed is designed to reduce the opportunity for squeeze tactics by seeing to it that there are enough independent concerns, which collectively control enough of the total supply at each stage of the productive process, to

[20] On Sept. 30, 1940, the government brought action against the American Petroleum Institute, the twenty-odd major oil companies and their subsidiaries, charging the defendants singly and collectively with violating the Sherman Act. Paragraph 34 of the complaint alleged that the defendants controlling the pipe lines had "combined and conspired to charge excessive rates for the use of crude oil and gasoline pipelines and to receive back as refunds and rebates on the rates charged to themselves a substantial part of the revenue from pipeline operation" and that this practice enabled them "to enjoy an unfair competitive advantage over their independent competitors. . . ." Complaint, *United States v. American Petroleum Institute,* District of Columbia, Sept. 30, 1940. Trial of the case was deferred because of the war.

[21] In the government brief (filed Mar. 2, 1946) in the recent A & P antitrust case [*United States v. The New York Great Atlantic and Pacific Tea Company, Inc.,* 67 F. Supp. 626 (1946)], it was pointed out that the company had organized a merchandising committee to coordinate the advertising and merchandising activities of all divisions and units at the retail level ". . . 'especially on all subsidiary-manufactured products and their competing nationally and sectionally known brands.' The advantage of this promotion was that the A & P products were exclusive to A & P and their prices could not be cut by competitors. They could be made to attract and hold a large number of customers who would also buy other products in A & P stores. An increased volume of sale of A & P products enabled a store to earn sufficient profits to keep its price on outside brands in a stronger competitive position. A & P products are the largest single source of profits to the A & P, and one aim of the promotion was to increase these profits by increased volume." (Pp. 41-42.)

prevent vertically integrated enterprises from acquiring an individual or group monopoly. This program would also attempt to prevent the squeeze by preventing vertically integrated concerns from developing greater proportionate control at one stage of an industry than at another. The practical difficulties and limitations of such a program have already been outlined.

In addition to such measures, it would be desirable to prohibit specifically the use of squeeze tactics. But the practical difficulties of doing so appear to be insuperable. Under the Sherman Act a squeeze is unlawful only if its effects are so far reaching that it appears to be part of an effort to create a monopoly. Systematic advantage for the vertically integrated concern and systematic extension of its activities at the expense of its competitors may prevail for some time before such effects are obvious. To catch such situations in their early stages, the law might prohibit vertically integrated enterprises from using price or service practices by which their profits are unreasonably shifted from one level of operations to another or by which they jeopardize the survival of nonintegrated concerns with which they deal.

To frame such a statute, however, would be a delicate matter, and to apply it successfully would be difficult. A test based upon profits would require examination of costs and margins throughout the vertically integrated enterprise and would presuppose imputation of reasonable relationships among these factors at different stages of the industry. An attempt at precision in such imputations would narrowly circumscribe the discretion of the management of the enterprise in adjusting prices to changing conditions. Similarly, it would be impossible to distinguish clearly between price and markup policies designed to jeopardize competitors and similar policies that merely reflect unprofitable exploration of new markets. There would be great danger that an effort to apply such standards would have the effect of preventing vertically integrated enterprises from competing vigorously against nonintegrated competitors, particularly wherever the survival of any nonintegrated concern was jeopardized by the competition.

The most plausible form for such a statute would be one designed to prohibit in general terms the intent or effect of squeezing competitors but to leave the nature of the practice to be ascertained case by case as is done in enforcing other antitrust legislation. It can be argued that substantial alterations of policy designed to exert pressure upon particular groups of competitors would leave a fairly clear trail in the records of an enterprise. However, even though cases suitable

for prosecution might be discovered by the subpoena of business records, the fear of prosecution would be likely to result in a substantial impairment of vigorous competitive incentive. Measures directed at the structural characteristics of powerful integrated concerns are more promising than those that are designed to control the behavior of such enterprises.

Tying Arrangements

Competitors are sometimes coerced or destroyed by contractual devices through which they are gradually excluded from the market. One example of such a device is the so-called "tying contract," in which buyers are required to purchase a specified amount of commodity B from a given concern as a condition of agreement by that concern to supply them with a specified amount of commodity A.[22] The effect of this type of contract is to deprive other enterprises of the opportunity to sell commodity B to these customers. If a substantial part of the total market for commodity B is covered by such contracts, the effect may be to jeopardize the competitive position and even the existence of the excluded producers. Moreover, the concern that has been able to protect in this way its sales of commodity B need not be fully responsive to competition in determining the price and quality of that commodity.

A related type of tying arrangement is the exclusive-dealing contract, which binds a buyer to make all his purchases from a particular seller.[23] It differs from the tying contract in that (1) it may cover a considerable range of commodities; (2) it usually is explicit in limiting the buyer to a single source of supply; and (3) unlike many tying contracts, it leaves no freedom to buy from others after a designated quota of commodities has been purchased under the contract.

In the case of distributors, exclusive trading arrangements may be two-sided. The producer may require the dealer to refrain from handling the goods of others, and in turn the dealer may receive a guarantee that within a given area he will be the only distributor of the producer's goods. Thus a particular distributor's service may be tied to a particular producer's product in such a way that if either is desired by a consumer the other must be accepted also. Alternatively,

[22] See *Federal Trade Commission v. Gratz et al.,* 253 U.S. 421 (1920).

[23] See *International Business Machine Corporation v. United States,* 298 U.S. 131 (1936); *United Shoe Machinery Corporation v. United States,* 258 U.S. 451 (1922); *Federal Trade Commission v. Sinclair Refining Company,* 261 U.S. 463 (1923).

by preempting the available distributors,[24] the producer may impair the opportunity for other producers to find distributive outlets; or by preempting supplies, the distributor may reduce the opportunity for other distributors to find goods to sell.

Tying arrangements are often expressions of some form of differential bargaining advantage enjoyed by the concern that initiates them. Where two commodities are united in a tying contract, the vendor has some form of special advantage in the sale of one which induces the buyer who wants it to accept a restriction upon his freedom as to the other commodity. The buyer agrees to purchase exclusively from one source when he regards the opportunity to deal with the vendor as of great importance. Where the distributor obtains exclusive rights to sell within his trading area, he often has a dominant position within the area in which he is afforded protection. Thus exclusive arrangements often serve to consolidate strength already acquired and to extend the effect of that strength over new commodities and new markets. The existence of a tying arrangement increases the dependence of the tied concern and thus enlarges the opportunity for the tying concern to impose new exactions and to substitute its business discretion for that of the other party to the contract.[25]

In the absence of special bargaining strength and of a narrow limit upon the number of commodities or distributive outlets, tying arrangements may lack coercive effect. Many such arrangements in distribution are not significantly coercive. A manufacturer may give his distributors exclusive rights, not because he has no other satisfactory means of access to their localities, but because he hopes that they will be induced to identify their business fortunes with his product and hence to promote it more vigorously. Such a policy is peculiarly probable if the product is new and requires a substantial amount of promotional effort. A dealer may undertake to carry a manufacturer's full line, and even to refrain from carrying rival lines, in the hope that

[24] See *United States v. International Harvester,* 214 F. 987 (1914). See also the discussion on pp. 196, 199.

[25] Ford agencies, for example, have been expected, at different times and places, not only to handle Ford cars exclusively but also to refrain from handling parts manufactured by independents, to sell a minimum number of Fords, to sell fixed quotas of Lincoln and Lincoln-Zephyr automobiles, and to maintain their business premises in accord with standards established by the Ford Company. See Federal Trade Commission, *Report on Motor Vehicle Industry,* House Document No. 468, 76th Congress, 1st Session, 1939, pp. 152, 159-161, 182, 200-204, 262-263, 1071.

thereby he will merit more hearty cooperation in the provision of selling aids and in the extension of credit. If there are ample opportunities for competing producers and dealers to build up comparable exclusive arrangements, competition may remain active and competitors uncoerced.

The preferable method of attack upon coercive tying arrangements is to diminish the bargaining advantage that gives the power to impose such contracts. A reduction in the size of dominant concerns increases the number of available alternatives, and destruction of monopolistic control over one commodity destroys the power to tie other commodities to it.

Nevertheless, a direct attack upon coercive tying arrangements is desirable, lest a failure to establish adequate competition at one point in the economic system may become the basis for a progressively wider destruction of competition elsewhere. Since many tying arrangements are innocent, exclusive contracts and contracts conditional upon the purchase of other commodities cannot be forbidden as such. However, it should be possible to identify and forbid types of tying contract that are peculiarly capable of abuse. Concerns that enjoy a legal monopoly over any commodity or service, whether from patent, franchise, or other source, should be forbidden to use tying contracts and exclusive dealing arrangements in connection therewith. Similarly, tying arrangements should be prevented wherever the producer sells, or the buyer buys, so much of the industry's total output that those who deal with him would have trouble in looking elsewhere. Distributors should also be forbidden to use exclusive arrangements where they do so much of the total business in an area as to make access to the local market difficult without their help. Such prohibitions should be supplemented by a general provision against the use of tying arrangements in any case in which they are found to have coercive or monopolistic effects.

Section 3 of the Clayton Act,[26] which now forbids tying arrange-

[26] "It shall be unlawful for any person engaged in commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease,

ments, is not adequate to give effect to the foregoing suggestions. This section makes it unlawful to condition a sale or a price adjustment upon the purchaser's avoidance of purchase from a competitor of the seller where the effect may be to substantially lessen competition or tend to create a monopoly in the line of commerce. Apart from possible minor differences, the test of illegality in this section is that used in the Sherman Act.[27] Thus the section adds little to the antitrust laws, though its enactment probably helped the courts to see that tying contracts may promote monopoly.

In a revised statute the definition of tying arrangements should be extended to include all arrangements that have the effect of binding or inducing any buyer or seller to deal exclusively with another, and likewise all arrangements by which the purchase or sale of one commodity is made conditional upon the purchase or sale of others.[28] It should also cover similar arrangements applicable to agencies and consignment sales. All tying arrangements should be illegal if they are brought about by coercive pressures or if they have the effect of coercing competitors, excluding them from the market, or substantially lessening competition. This blanket prohibition should be supplemented by more specific provisions forbidding tying arrangements applicable to any commodity or service which is subject to a legal monopoly and tying arrangements where either party to the transaction controls a preponderant amount of the total output or of the total sales within a trade area.

Reciprocal Buying

A reciprocal buying arrangement is one in which the buyer agrees to purchase one commodity from a seller provided the seller of that commodity will purchase another from the buyer. Thus other pro-

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sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any such line of commerce."

27 The Sherman Act speaks of an attempt to monopolize, whereas this statute speaks of a tendency toward monopoly. The Sherman Act speaks of a part of commerce, this statute of a line of commerce. This statute covers substantial lessening of competition as well as a tendency (or attempt) to create a monopoly. These differences do not appear to be very significant.

28 The latter type of contract has been included within the meaning of the present Section 3 of the Clayton Act by interpretation. See *International Business Machine Corporation v. United States,* 298 U.S. 131 (1936).

ducers of both commodities are deprived of an opportunity to sell to the contracting parties. If neither concern has any substantial size or power as buyer or seller, the arrangement may be unimportant. In such a case it is likely to be, not a formal undertaking, but merely an exchange of business courtesies which would not survive against competitive inducements from other sellers. Between two powerful concerns, however, reciprocal buying may be a device by which each supports and helps consolidate the strength of the other, so that independent producers of both commodities are deprived of market opportunities.

Formal reciprocal buying contracts could be readily forbidden. However, such a step would have little value if its effect were merely to substitute a tacit understanding under which the practice of reciprocal buying continued. In any attempt to cope with such tacit understandings, it would be necessary to distinguish them from instances in which concerns become one another's customers because each is the best and cheapest source of supply for what the other wants. The only way to make such a distinction would be to outlaw in general terms reciprocal buying that has the effect of substantially lessening competition or that tends to create or support a monopolistic position, and then to attack particular reciprocal buying arrangements, case by case, upon the basis of their own peculiar effects.

Under the present law reciprocal buying is illegal when it contravenes the general prohibitions of the Sherman Act against unreasonably restrictive agreements and efforts to create monopolies. Although the test proposed above is merely the Sherman Act test, a specific prohibition would have the advantage of indicating that Congress believed the practice capable of jeopardizing the broad purposes of the law. Thus, like certain portions of the Clayton Act, it probably would lead to a more effective attack upon reciprocal buying arrangements.

EXPLOITATIVE ACTIVITIES

Exploitative types of business behavior, that is, practices designed to obtain monopoly profits from customers, are even more difficult to define and prohibit than coercive practices. In so far as large enterprises have monopolistic power in spite of programs to limit their size and to prevent them from coercing their competitors, this power will be felt in prices, volume of production, and the quality of goods. If it were

possible to protect consumers by direct prohibition of monopolistic behavior, the effectiveness of the antitrust laws would be enhanced.

Unfortunately, however, monopolistic marketing practices cannot be defined sharply enough to be explicitly prohibited. Specific types of collusive agreement can be prohibited because the content of an agreement is necessarily identifiable and because in preventing agreements one does not significantly reduce the liberty to make individual decisions. To prohibit acts by single enterprises is far more difficult. It is feasible only in so far as these acts can be readily distinguished from legitimate activities. As has been indicated above, even in the case of coercive activities directed at competitors such distinctions are not easy to make; and identification of exploitative activities directed at consumers is harder still.

To illustrate the problem, let us consider the possibility of extending the general law about unreasonable restraints of trade so that it becomes applicable not only to agreements but also to the activities of single enterprises. The Sherman Act forbids not only illegal contracts and conspiracies but also illegal "combinations," and the suggested extension of the law could be accomplished if the latter term were defined, as it reasonably might be, to include any corporation, and if the restraint imposed by the combination were found in the market policies of the concern. No such interpretation has heretofore been attempted. The question to be considered is not whether there is a legal case for such a reading of the statute but rather whether such an extension would be desirable and feasible.

It would be wholly impractical to apply a single rule to the content of business agreements and the behavior of individual corporations, and to curb the latter to the full extent to which curbs have been placed upon the former. Price fixing by agreement is illegal, but determination of its own prices by a corporation is inevitable. Restriction of output by agreement is probably illegal. Applied to a single corporation, such a rule would be a requirement that the concern operate always at capacity. Agreements to limit new capital investment are probably illegal. It is not clear how an analogous rule could be applied to a corporation's decision not to expand its productive facilities further.

The only plausible way in which the behavior of individual corporations might be controlled by lawsuits would be by developing a new rule of reason applicable to the management of large concerns. A statute which directed that corporations be managed generally in the

interest of efficiency, full production, and sale at reasonable prices would, for example, be a rough equivalent in the generality of its terms to the present law that agreements avoid unreasonable restraints of trade. An enforcement agency entrusted with the duty of interpreting such a law would probably be able to develop some working rules of reason on a case-by-case basis. In doing so, however, it would have authority to intervene in all important details of corporate management. In contrast to the antitrust laws, which are devoted to preserving a diversity of business initiative, a statute of this kind would transfer to the government responsibility for major matters of business policy. It would be one way of approaching collectivism, but not a way of preserving competitive private enterprise.[29]

A more limited direct attack might be made upon the exploitative practices of monopolies. The history of the common law offers some interesting suggestions along this line. Certain types of concerns that are in a peculiarly strong position to exploit their customers have long been defined at common law as "industries affected by a public interest," and as such have been subject to special requirements. Business enterprises that have attained great size and that cannot be dissolved might be treated similarly. They might thus incur an obligation to serve all applicants without discrimination and on reasonable terms up to the limits of their capacity to do so. Thus refusal to sell based upon an effort to exact unreasonable prices might become actionable, as well as discrimination in the terms of sale. In applying such a rule it would be necessary in each case to determine, in effect, minimum prices below which curtailment of activity was reasonable and maximum prices above which unreasonable exploitation must be inferred. It would also be necessary to determine whether or not stated relationships between prices and services to different groups of customers and upon different commodities jointly produced were unreasonably discriminatory. In much of the public-utility field, requirements of this kind have evolved into comprehensive schemes of public regulation over prices and services. However, the original method of the common law, which prevails in modified form to various degrees among some industries affected with a public interest—for example, hotels—was to give the injured person a right of action against the

29 The British Labor Government has adopted such a policy of control over management, applicable to agricultural land. See Agriculture Bill, presented by Thomas Williams, printed Dec. 18, 1946. See also *Time,* Sept. 29, 1947, pp. 34-37.

exploiting businessman. In view of the complexity of the issues involved, a right of action for ultimate consumers or even for distributors or industrial customers would be likely to remain unused. But a right of appeal to a public agency which would have the power to conduct an investigation and make a finding might have some effect. By such a device, abuse of power by large enterprises might be mitigated, but at the cost of considerable surveillance by the state.

Such an experiment as this need not and should not be made on a comprehensive basis. Rather, when a large business unit is found to be inevitable in a particular industry, control of this type is one of the possible alternatives of public policy. If there should be experiment with this form of control, the results of the undertaking could determine to what extent further experimentation might be justified.

THE POSSIBILITY OF CONTROL THROUGH GOVERNMENT SURVEILLANCE

Thus far this chapter has discussed the possibility of coping with coercive and exploitative behavior by legal prohibitions and antitrust proceedings. It has expressed the view that this possibility is sharply limited. However, there are other devices by which abusive practices by large business enterprises might conceivably be curbed. In general, they involve use of regulatory rather than prohibitory techniques.

A form of control over large enterprises which has been repeatedly proposed in public discussion and has been adopted in other countries in particular cases is the establishment of a mixed private and public management, through which governmental representatives maintain a continuous surveillance over the activities of the concern. Such experiments may take the form of government membership upon boards of directors or of the use of government observers or of government supervisory officials with rights of veto, who have access to the deliberations of the board and to the records of the enterprise. It is urged that such an arrangement can protect the public interest more fully than public regulation and yet is more flexible, quicker, and less costly.

The objections to governmental participation in management are overwhelming. Such arrangements are frankly based upon an inability to prescribe in advance the public policies to which business shall conform, for if such prescription is possible other methods of regulation are sufficient. In the absence of a definite public policy, the government officials who assume managerial responsibility are un-

guided and unchecked, relieved of political responsibility for their acts, and surrounded with a protective cloak of secrecy which conceals their errors and misdeeds. Protection of the public interest becomes a gamble upon their foibles. Moreover, the sharing of control between public and private persons is objectionable. With majority control or a veto the government carries full responsibility. Under such circumstances decisions in the enterprise are not privately made, and there is no satisfactory reason why profits should be privately received or risks should be privately borne. Such a method of organization imposes upon economic activity whatever inefficiency, inertia, and political deflection may be inherent in government control, but does not relieve it of the pressure of private cupidity. If, on the contrary, the government has a minority position and lacks a veto, it becomes partly responsible for policies which it may not approve and thus loses much of its opportunity for corrective public action. Public policy is thus subordinated to private business decision.

The only form of mixed organization that is free from these objections is use of a government observer who does not participate in the decisions of the enterprise. Continuous personal surveillance by such an official expresses one of many possible degrees of a requirement that large enterprises make more information available to the public and the government than do small enterprises. At one extreme, government officials might enjoy unlimited rights to examine the records and quiz the officials of the concern. Use of a government observer is less drastic in that it limits these inquisitorial rights to the activities and documentary evidence that come before the board of directors. Still more modest programs might require large concerns to report their activities regularly to the government or to make special reports of particular activities and relationships. Again, governmental agencies might have rights to investigate large enterprises on charges of unwise or improper action that are not sufficient to constitute a violation of law and hence would not support an ordinary use of the subpoena power.

Such programs of surveillance are capable of providing two forms of protection against the power of large enterprises. First, the probability that the acts of the concern will become known to the government and possibly to the public provides an incentive against behavior that is illegal or generally regarded as reprehensible. What cannot be defended is less likely to be undertaken. Second, as new types of objectionable practice are developed, the government is likely to know

about them sooner and to have an earlier chance to prevent them by appropriate action.

However, there are offsetting dangers. On the one hand, predatory and corrupt government officials may use their special information about large enterprises to line their own pockets and enhance their personal power. On the other hand, this type of control, when honestly attempted, may be ineffective. The government's knowledge of what is being done may be interpreted as approval, and if no governmental objections are made, a questionable activity may be pushed further than it would have been in the absence of surveillance. Furthermore, a new practice that is not quickly outlawed is likely to be harder to prohibit subsequently because it will appear to have been developed with government sanction. Thus complaisant public officials may convert surveillance into license. Continuous surveillance without public disclosure maximizes this risk.

To minimize the dangers of corruption and complaisance, it is desirable to avoid continuous surveillance by government officials over business enterprises except through the requirement that such concerns regularly submit public reports. Unusually comprehensive reporting is appropriate for concerns which are so large and powerful that they have unusual opportunities for abuse and unusual significance in the economy as a whole. Full disclosure of their corporate structure, ownership, and intercorporate connections and full financial statements at annual or shorter intervals should be required.

Moreover, some of the preventive effects of publicity may be obtained, without great danger that the government's investigatory power will be abused, by affording a government agency unusual rights to make periodic investigations designed to discover whether the reasons for allowing such concerns to be large continue to exist and whether the power acquired through bigness has been seriously abused. The investigatory powers of such bodies as the Federal Trade Commission are generally circumscribed in an effort to avoid so-called "fishing expeditions," and this limitation is appropriate in coping with ordinary competitive business. But concerns that are so large as to create unusual dangers may properly be dealt with by taking unusual precautions. For this reason, the government's power to investigate such concerns should be broader than that which it exercises generally, and should be used more frequently than would be generally justified.

However, the distinction between *ad hoc* investigation and continu-

ous surveillance should be carefully maintained. Wherever there is need for the latter, the need should be met by special legislation applicable to the particular case, and precautions should be taken to prevent the information obtained from remaining secret and thus becoming the basis for a tacit partnership between big business and government officials.

VI. ENTRY AND ACCESS

TO PRESERVE THE opportunity for additional enterprises to enter a market is a highly important objective of a competitive policy. Obstacles to the formation of new enterprises and barriers that exclude existing enterprises from markets they wish to invade are influences that decrease the vigor of competition. So long as entry is easy, the potential competition of new technology, new business methods, and new marketing policies tempers the behavior of the concerns already present. The effects of this potential competition are to reduce the likelihood of collusive agreement, to moderate the restrictions in agreements actually made, to lessen the restrictive effect of concentrated control over production or purchases, and to diminish the advantage which the most powerful enterprise can obtain through coercion.

In addition to thus reducing the possibilities for avoiding competition and mitigating the restrictions in anticompetitive policies, easy entry is a safeguard against routinization of industrial activities. When established competitors in a market drift into a policy of live and let live as to prices, quality, marketing methods, or the adoption of new productive techniques, invasion of the market from outside is likely to shake them from their lethargy.

The degree of difficulty which a new concern experiences in entering an industry is determined in part by the industry's technology and methods of business organization and in part by the restrictive devices which have been set up to hamper newcomers. Ease of entry necessarily diminishes with each increase in the scale of operation that is required for efficiency in production or distribution. The increase in mechanization requires larger productive establishments. The growth of markets and the elaboration of sales techniques require greater initial expenditures to obtain the necessary minimum volume of sales. Although a few industries and many trades are still open to individuals who desire to launch an enterprise with their own savings and under their own management, an increasing proportion of business opportunities today is open only to concerns with substantial amounts of capital. The minimum scale of operation necessary for survival dif-

fers, of course, from industry to industry. To enter the steel business can never be as easy as to enter dress manufacture or hardware retailing. However, even the smaller manufacturing units are likely to be too large for business undertakings by individuals. The opportunity for the ordinary citizen to go into business for himself is rapidly diminishing.

Though this change profoundly affects individual opportunity and has many important social and political consequences, it does not necessarily destroy the effectiveness of the safeguards afforded by potential competition. If some individuals and many groups have opportunities to enter an industry, there is potential new competition, even though many other persons have no such opportunity. Professional promoters, professional vendors of new securities, and wide markets for speculative investments have arisen to simplify the task of launching large new business undertakings. Indeed, as has already been said, modern investment banking is better adapted to large security flotations than to small ones. Such specialized institutions provide partial offsets to the increasing difficulty of launching a new enterprise. Moreover, with such facilities at hand, established concerns find it easier to expand and diversify their operations; and thus enterprises in one industry more readily become potential competitors of those in another.[1]

But the chance that new competition will arise is reduced by the fact that a great sum must be risked upon a new venture; for a large risk is not justified unless there is prospect of a substantial profit upon a relatively large volume of business. In an industry of many small business units, some newcomers may be expected to establish themselves in response to relatively small changes in incentive;[2] but in an industry of large business units, minor opportunities to sell more goods or to make more money are not likely to furnish sufficient inducement for new ventures. Moreover, the large enterprise, once established, can

[1] The process of expansion and diversification by concerns in other industries exposes any one industry to greater potential competition from outsiders. It may also, if it proceeds far enough, create the problems of excessive size which are discussed in Chap. IV. Thus the expansion of large concerns may reduce certain obstacles to competition while it creates others. The proper goal of policy with respect to size is to prevent degrees and types of expansion which create problems more serious than those they solve.

[2] The incentive to launch a small business undertaking may be, not merely a small and perhaps local increase in the opportunity to make a profit, but also a reduction of alternative opportunities to make a living. For example, loss of his job may induce a skilled workingman to go into business for himself.

seldom be displaced without a desperate struggle, whereas the small business may be easily discouraged or destroyed by a change in business conditions. Thus in an industry of large business units, a newcomer must expect great difficulty in replacing a going concern. As business units become larger, they obtain greater leeway for restrictive practices before the influence of potential competition makes itself felt, though they also incur more formidable risks if they push their restrictions so far that large new competitors actually appear.

The weakening of the safeguards of potential competition by technical and organizational changes cannot be wholly avoided, although it can be reduced by attacks upon excessive size and upon coercion such as have been proposed in previous chapters. But in so far as potential competition is further weakened by deliberate restrictions applicable to new enterprises, countermeasures can be taken. Efforts to make potential competition a stronger check upon business policy should be directed primarily toward removal of such restrictions.

Opportunity for established concerns to obtain ready access to the market is as important as opportunity for new concerns to enter the industry. Difficulties of access have effects like those of difficulties of entry: they enhance the likelihood that the concerns that have already obtained access will engage in restrictive and coercive policies.

BARRIERS OF DISTANCE AND DELIVERED PRICE FORMULAS

The problem of access varies from industry to industry according to the size and location of the producers and the character of the market. In industries whose products are perishable or expensive to ship, the more distant concerns are substantially handicapped, so that competition is difficult except within local or regional groups. Since expenses for transportation and spoilage can usually be predicted with considerable accuracy, the barrier that handicaps the distant enterprises can be roughly expressed in dollars and cents. But the effect of the barrier is not uniform. In some cases local concerns obtain leeway in the price policy applicable to their local sales, and the size of the barrier roughly measures the additional amounts that may be exacted from local consumers by a local monopoly or a local collusive group before outside competition must be feared. In other cases the effect of the barrier is not to raise local prices but to reduce the net receipts of the more distant enterprises which incur relatively heavy costs in reaching the local

market. Such reductions do not necessarily exclude distant competitors; for if these competitors operate under conditions of overhead cost, they may believe that they can afford to invade distant markets at delivered prices which give them lower realizations from sales than they expect in their home markets. Indeed, this willingness to regard sales at a distance as by-products of home-market operations may be so great as to make the distant concern the most aggressive competitor in reducing prices. In some cases the relationship between concerns at varying distances from the market is given a definitive character by pricing formulas which determine to what extent and in what markets local concerns shall raise their prices to take advantage of their distance from their competitors and to what extent and in what markets distant concerns shall absorb the expense of reaching the market in order to make sales. The best known of these formulas is the so-called "basing point system," under which all sellers, no matter where located, quote prices at certain key points, and in selling elsewhere add the freight from the nearest key point to the point of sale.

But whether the barriers of distance are reflected in reduced profits for the distant concerns or higher prices and profits for the near-by concerns, they give an advantage to those that are near and impose a handicap upon those that are remote. Since enterprises ordinarily lie at various distances from any market, there is a series of such barriers, and penetration of each admits to the market a new group of competitors.

Under a competitive policy the existence of such localized and limited monopolistic advantages must be taken for granted as an inherent characteristic of concentrated production and wide market areas. It is a problem for the policy maker only with respect to the question whether any control shall be exercised over the way in which the barriers affect policies as to prices and sales. In various industries in which basing point systems are employed, concerns that lie at a basing point are given an opportunity to sell in all areas tributary to that base without incurring any disadvantage of reduced profits as the distance increases. Concerns that lie at a distance from the base are enabled to increase prices in their local markets by the full amount of the transportation charges from the base, even though they incur no such charges in their actual sales. In selling away from their local markets, such concerns need experience no appreciable decrease in net realization from sales if the sale is in a direction away from the base, but

must suffer a peculiarly sharp reduction in this net in selling toward the base.

Other types of pricing formulas have other peculiar effects upon the opportunity for access to markets. Moreover, in all such formulas, the advantages and disadvantages of location are so handled that they do not affect the relative delivered prices quoted by different concerns at particular points. So far as problems of distance are in question, all delivered prices are uniform though transportation costs, on the other hand, are not.

Geographical pricing formulas have been under attack as collusive devices to eliminate price competition, as discriminatory devices through which purchasers are denied the opportunity to benefit by relative nearness to sources of supply, and as wasteful devices through which sales at a distance from points of production are encouraged, with a consequent increase of total shipping costs and of price levels. That such effects are prevalent in basing point systems and in systems under which uniform delivered prices are quoted throughout a geographical area has been convincingly demonstrated.[3] Therefore efforts have been made to eliminate such geographic price formulas by prosecuting them as restrictive agreements and as instances of unlawful price discrimination.[4] Suggestions have also been made that basing point systems should be explicitly forbidden by statute.[5]

An economist who has advised the FTC but who apparently does not express the commission's official views has contended that a proper handling of the problem of distance between producer and customer requires establishment of a price at each point of production and addi-

[3] See, for example, Frank A. Fetter, *The Masquerade of Monopoly,* Harcourt, Brace & Company, Inc., New York, 1931; Federal Trade Commission, *Price Bases Inquiry,* March, 1932; *The Zone-price Formula in the Range Boiler Industry,* March, 1936; TNEC Monograph No. 42, *The Basing Point Problem;* and testimony of Commissioner Freer before the Senate Committee on Interstate Commerce, *Hearings,* S. 4055, 74th Congress, 2d Session, Mar. 23, 1936. The TNEC monograph also contains a defense of basing point systems.

[4] See *Corn Products Refining Company v. Federal Trade Commission,* 324 U.S. 726 (1945); *Federal Trade Commission v. A. E. Staley Manufacturing Company,* 324 U.S. 746 (1945); and *Aetna Portland Cement Company et al. v. Federal Trade Commission,* 157 F. (2d) 533 (1946). The Corn Products and Staley cases involved a single basing point system, while the Cement case involved a multiple basing point system. While this book was in press, the Cement case was won by the government before the Supreme Court.

[5] S. 4055, 74th Congress, 2d Session, *To Prevent Uniform Delivered Prices.*

tion of full freight incurred in shipments to other points. Apparently he recommends adherence to this formula so rigidly that the producer would not be free to absorb freight from time to time in particular transactions in order to make sales at points nearer to another producer.[6] The effect of such a rigid system of pricing f.o.b. mill would be to prevent purchasers from obtaining supplies from the more distant producers except by paying more than local producers would charge. Thus in any case in which a single producer was appreciably nearer than all others, the purchaser would find it difficult to deal with more than one source of supply. The effect of such a system would often be to deprive buyers of satisfactory alternatives in cost and service unless they were willing to pay a premium. Moreover, under such a system an increase in the prices charged by an isolated producer would deprive him of sales only to the buyers lying at the outer edges of the territory in which he formerly had a price advantage; and in any case in which this area was relatively devoid of buyers and hence unimportant to him, the monopolistic advantage enjoyed near his point of production could be made the basis for a monopolistic price policy. Therefore, the uniform adoption of f.o.b. mill pricing without any possibility of freight absorption would be of questionable advantage to the public interest.

The objective of public policy with reference to the effect of distance upon access to the buyer should be to reconcile two values. First, sufficient opportunity for interpenetration of sales territories should be preserved to provide a check upon monopolistic advantages such as the near-by concern may enjoy in local markets. Second, the delivered prices charged in selling into the home markets of other concerns should be prevented from falling into a pattern so rigid as to facilitate price-fixing agreements or so generous to the selling interest as to enable sellers to make high charges based upon the addition of fictitious freight expenses. To meet the first point, absorption of freight charges to reach distant markets should be permitted. To meet the second point, adherence to rigid pricing formulas should be prevented

[6] The economic analysis underlying this point of view has been most forcefully and persuasively argued by Prof. Frank A. Fetter (*op. cit.*, especially Chap. 20). However, the orders issued by the Federal Trade Commission have not accepted this principle without qualification. They leave room for sporadic freight absorption.

and devices for collecting phantom freight should be outlawed as discriminatory.[7]

It appears probable that pricing formulas which are generally followed by competitors can be successfully attacked under the present antitrust laws as restrictive agreements. Litigation now before the courts raises most of the relevant issues, so that the point will soon be clarified by judicial decisions.[8] If gaps appear in the law they should be filled, and it would be appropriate to include a prohibition of the systematic use of formula pricing in any codification of forbidden practices which might be enacted. Similarly, recent court decisions indicate that the price discrimination provisions of the Clayton Act are probably sufficient to cope with efforts to collect phantom freight.[9] On

[7] Some defenders of basing point systems argue that a basing point formula is merely a regular procedure for freight absorption, and that to prevent the former is necessarily to prevent the latter. Most basing point systems include procedures for collecting fictitious freight upon a portion of the sales, sometimes by pretense that the product originated where it did not and sometimes by pretense that it was shipped by a more expensive method of transportation than was actually used; and to this extent such systems are substantially different from systematic formulas for freight absorption. However, if every producing point were a base and all transportation charges were computed at the lowest available transportation costs, phantom freight would be eliminated, and systematic freight absorption would be the essence of the basing point system. Such a formula might be described either as a multiple basing point system or as an f.o.b. mill system with freight equalized to that of the competitor possessing the greatest freight advantage.

Although this type of basing point formula would avoid some of the abuses which appear in most actual basing point systems, its systematic character would still permit it to be used for collusive purposes. Such systematic matching of delivered prices with competitors is not the only way in which a competitor can absorb freight to make a sale. In various markets where such formulas have not appeared, there is sporadic and unsystematic freight absorption, in which neither the willingness to grant a price concession nor the amount of the concession is predictable by competitors. This type of price competition need not be prevented in order to get rid of basing point formulas.

[8] Although the appellate court set aside the Federal Trade Commission order against the multiple basing point delivered price system of the cement industry [*Aetna Portland Cement Company et al. v. Federal Trade Commission,* 157 F. (2d) 533], its opinion accepted many of the commission's arguments, expressed approval of a large part of the order, and stated that the order was set aside to expedite appeal of the disputed points. The commission appealed the case to the Supreme Court, which sustained the commission's contentions while this volume was in press.

[9] See *Corn Products Refining Company v. Federal Trade Commission,* 324 U.S. 726 (1945) and *Federal Trade Commission v. A. E. Staley Manufacturing Company,* 324 U.S. 746 (1945).

the assumption that further litigation discloses no unforeseen gaps in the law on this question, the discriminatory aspects of geographic pricing are adequately covered by statute. What is needed in this field is sustained enforcement adequate to bring business practice in line with public policy. It is to be hoped, however, that the FTC will not seek to require rigid f.o.b. mill pricing in the terms of orders which it issues in cases of this class, or that the courts will modify the commission's orders sufficiently to avoid this result. Otherwise, there will be need for amendment of the statutes designed to preserve adequate competitive alternatives in markets in which producers are widely scattered.

BARRIERS DUE TO SALES EFFORT

Access to markets is also made difficult in many cases by the dispersion, lethargy, and established preferences of the buyers. To have physical access to the market area is not always to have effective opportunity to sell there. To obtain the latter one must find customers and persuade them to buy from a new source of supply, in spite of the sales effort which has been and is being expended by their present suppliers. The cost of such discovery and persuasion may be substantial.[10] It, too, constitutes a financial barrier against outside competition, although the size of the barrier cannot be stated with precision. This type of market advantage for established concerns must also be taken for granted as an environmental fact which may create individual or group monopolies of limited effectiveness. Competitors that are well and favorably known must be expected to be able to convert their prestige into a relatively large volume of sales or a somewhat higher level of prices. Nevertheless, there is no need to acquiesce in the extremes of quasi-monopolistic advantage which are created in some markets in which the ignorance of buyers is exploited through the high-pressure sales techniques of sellers. The effect of sales effort in making prices rigid and enhancing the spread between costs and prices

[10] See testimony of Jerome W. Ephraim before the Temporary National Economic Committee, *Hearings*, Part 8, "Problems of the Consumer," pp. 3396-3412. Efforts of this cosmetic manufacturer to enter the national market with a new brand of toothpaste required greater funds for advertising expenses than he could afford. An initial figure of $100,000 was quoted him merely to explore the possibilities of sales on a nationwide basis. Large and small outlets alike refused to handle the product without preliminary creation of customer demand.

may be very great.[11] The protection afforded by alternative sources of supply, actual and potential, will be enhanced if means can be found to reduce the influence of ignorance, misrepresentation, and high-pressure sales effort in creating unjustifiable prestige, meaningless differentiation of products, and illogical price differences. Announcement of one's wares and persuasive selling are inevitable characteristics of competitive markets; and it would be impracticable, even if desirable, to regulate the amount of sales effort or the exact forms of persuasion to be used. Enforcement of the laws against fraud and extension of these laws to cover new and relatively subtle forms of misrepresentation are continuing processes which help keep sales effort within bounds, but they cannot be expected to keep pace with all misrepresentative tactics.

The most promising attack upon this kind of problem is an indirect one—provision of better market information designed to deflate exaggerated claims. Various devices are available for this purpose, and different ones are likely to prove most satisfactory in different parts of the economy. In some cases requirements for disclosure of the ingredients of products may be appropriate. In others, standardization, grading, and grade labeling may be desirable, either under public auspices or through the activities of trade groups. In still other cases there may be need for government testing and disclosure of the results of the tests, or for laws designed to exclude dangerous and substandard goods from the market. In some cases there may be need for a peculiarly close surveillance over the representations made in selling. Much may be done by education of consumers toward a greater awareness of the desirable and undesirable characteristics of such products as foods and drugs. There is considerable need for extension of the use of most of these devices and for exploratory work designed to find other ways of coping with the enduring problems of human ignorance, gullibility, and propensity to obtain one's ends by persuasive exaggeration.

However, the success or failure of the competitive policy does not depend upon the solution of this particular problem. Some obstacles

[11] For example, wide price differences occur among drug and cosmetic products with virtually identical chemical content. A comparison of the wholesale prices of various identical substances sold under proprietary and nonproprietary names as of July, 1938, revealed that the aggregate cost of one ounce of each of these products sold under nationally advertised labels was $28.95, while the aggregate price of one ounce of each product sold under their chemical names was $4.59. The price per ounce of a branded product was in some instances twelve times the price per ounce of the equivalent chemical product. See TNEC Monograph No. 1, *Price Behavior and Business Policy*, p. 81.

in reaching the market will necessarily be encountered because of ignorance and sales effort. The extent to which regulatory devices should be adopted to reduce these obstacles is a matter upon which disagreement is inevitable. But even if little or nothing were done to attack forms of sales effort that hoodwink and cajole consumers, such inaction would not be fatal to the competitive policy. It would make the results of competition less satisfactory, but it need not prevent competition from being vigorous or from establishing effective limits upon the possibilities of private exploitation of consumers.

PREEMPTION OF FACILITIES FOR DOING BUSINESS

Although difficulties of entry and access that are due to technology and geography must be accepted and those due to competitive sales tactics may be ignored in so far as the remedies for such tactics are considered undesirable, those due to deliberate interference with business freedom need not be given similar toleration. Many such difficulties are created by deliberate restrictions of opportunity. In general these restrictions may be divided into two classes: preemption of necessary facilities and imposition of collusive or legal barriers.

Entry into an industry or access to a market may be made difficult or impossible when those already engaged in it control the facilities which must be used in it and are unwilling to release any of these to a newcomer. Such control is like that which has already been discussed in Chap. V as a means of coercing or destroying established competitors. It may take the form of exclusive rights in strategic geographical locations which are indispensable to those engaged in the industry. Ownership of the reserves of certain raw materials—bauxite, anthracite coal, iron ore, copper, and the like—may be so concentrated as to make it extremely difficult for a new enterprise to get started in an industry that must use these materials. In other cases unpreempted supplies are available only in remote and unsatisfactory locations. Entry into the aluminum industry on the North American continent has been limited by the paucity of satisfactory sites for the production of electric power and by the fact that the sites best located and most readily developed on a scale suitable for private investment are, for the most part, owned or controlled by established concerns.[12]

Preemption of transportation facilities sometimes makes entry and access difficult. Since most forms of transportation are regarded as

[12] See footnote 1, p. 158.

public utilities and required to serve all comers, the difficulty usually takes the form, not of inability to reach a market, but of disadvantage in the terms upon which access may be obtained. Efforts by public regulatory bodies to enforce equal terms have not kept pace with the ingenuity of the regulated transportation companies in devising more subtle forms of discrimination. For example, independent oil producers who must use pipe lines controlled by the larger companies and independent anthracite mines that must ship over the anthracite railroads have been at a disadvantage because their shipments contribute to the profits of their competitors, and sometimes because of discriminations in price or service.[13]

Sometimes preemption takes the form of arrangements that prevent a newcomer from obtaining services that he finds indispensable. Marketing channels, for example, may be denied to the newcomer because all distributors are parties to exclusive dealing arrangements with established concerns.[14] Under pressure from established enterprises, banks may refuse to extend credit or may insist upon onerous terms.[15] Because of union contracts which bind organized labor not to work for concerns that are not members of an employers' organization, the newcomer may be unable to hire labor without the consent of established concerns that already belong to this organization.[16] Such arrangements may vary in severity, from formal contracts which wholly preclude deal-

13 See pp. 172-173.

14 *United States v. International Harvester Company et al.*, 214 F. 987 (1914). International Harvester had had the practice of distributing its various lines among all dealers in towns where there was more than one dealer and, with "exclusive contracts," limiting each dealer to one of the company's lines. Competitors were thus prevented from securing retail outlets. This practice was banned by the provision of the 1918 consent decree (248 U.S. 587) limiting the company to one agent in any city or town in the United States.

15 See pp. 103-104.

16 For example, *United States v. Contracting Plasterers' Association of Long Beach, Inc. et al.*, indictment under the Sherman Act, Feb. 2, 1940, Southern District of California, Central Division. Members of the defendant plasterers' association did about 90 per cent of the plastering work, members of the defendant dealers' association included substantially all of the retail dealers, and the defendant unions did approximately 90 per cent of the installing, applying, and handling of plaster materials in the Long Beach area during the period covered by the indictment. Among the objects of the combination, it was alleged, were monopolization and suppression, control, and elimination of competition in the sale and application of plaster materials in the area. According to the indictment, the defendant unions agreed to work only for members of the defendant plasterers' association and to handle only plaster materials sold through the defendant dealers' association.

ings with the new concern to tacit understandings which merely expose the newcomer to vexatious delays and uncooperative attitudes.

A pervasive method of handicapping newcomers is through control over technology. Many firms have developed productive skills which are only partly known to outsiders. It is to be expected that any new enterprise will be handicapped by the necessity of learning what its established rivals already know. These rivals are usually unwilling to assist the learning process. To the extent that their skills are kept secret from newcomers, entry into the industry is handicapped. If each merely keeps its own trade secrets from all others, old and new alike, the newcomer is not subjected to discrimination, although his lack of trade experience places him under a special disadvantage. Often, however, established concerns interchange their "know-how" and act together to solve their common problems. If technological cooperation is general among established concerns but is not available to newcomers also, the effect is to pool the experience of the industry as a competitive weapon against the new enterprise.[17]

The preemptions which have been discussed above are sometimes the result of a deliberate attempt to exclude outside competition. In such cases they necessarily express either the policy of a concern so powerful as to dominate the industry or the agreed policy of a number of different concerns. In this form they can be attacked as efforts to consolidate a monopoly or as agreements to restrict competition. If adequate safeguards are set up against restrictive agreements and the acquisition and use of monopoly power, there is, for the most part, no need to single out these particular manifestations of collusion and monopoly for special treatment.

However, a special problem arises as to the pooling of technology on a basis that discriminates against new enterprises. In a technological pool each established concern presumably contributes something to the others and obtains something from them, so that it gets a price for allowing the use of its trade secrets. Having no experience, the new

[17] In many cases the technology of an industry is subject to patents, and the disadvantages imposed upon the outsider are based largely upon the legal privileges conveyed by the patents. So far as this is the case, the matter is discussed below in connection with policy toward patents. However, all industries have substantial bodies of unpatented and unpatentable information, which may be used by each concern without interchange of experience or may be pooled wholly or partly. The joint use of such information by established concerns to the exclusion of newcomers is independent of the nature of patent law.

concern is not in a position to offer information in exchange for what it gets. Hence interchange of technology without charge to any participant would give the newcomer, not equal treatment, but a preferential position. This is particularly true in so far as the knowledge of the established enterprises is the result not merely of experience in the industry but also of expenditures upon research.

Nevertheless, businessmen who are willing to give newcomers equal opportunities for access to technology can find reasonable means to do so. For example, in a technological pool they can establish a schedule of fees, applicable to old and new concerns alike, for use of information contributed by others. Under such a system, a new concern, being less reliant upon its own technology, would be likely to pay more in fees than an old one; but its payments would be for value received. The government need not undertake to prescribe the means by which access to technology for new concerns is to be reconciled with the property interests of their established rivals. However, it should require technological pools to be open to newcomers on nondiscriminatory terms.

Preemption of facilities by established concerns may not always be the result of collusion or of monopolistic policy. It may be the unplanned result of efforts by each established enterprise to strengthen its own position against others by acquiring facilities for present and future use. This can be true in the case of natural resources, marketing channels, and unpooled technology. In such cases ordinary laws against collusion and monopoly cannot be effectively applied, and the question arises whether special measures are needed to preserve opportunities for newcomers.

So far as scarce natural resources are concerned, such protection appears to be both feasible and desirable. Although established enterprises should not be prevented from using what they currently need on the theory that someone else might want to use it later,[18] they should not be permitted to acquire reserves for future use to an extent which forecloses future opportunity for others.[19] Measures to keep reserves

[18] Conservation of scarce and irreplaceable resources is, of course, appropriate; but the need for it should be determined by analyzing present and future needs for consumption, not the needs of potential competitors for productive facilities.

[19] The Federal Leasing Act (66th Congress, 2d Session, Ch. 85, 1920) provides that coal lands owned by the government may be leased to private parties but that the maximum limit for a single lease shall be 2,560 acres. Through limitation of the number of leases that may be held by a single person, a ceiling is placed upon the

available for newcomers are an appropriate part of a competitive policy. A program appropriate to this end should be based upon study of our national resources and determination of the instances in which the future supply is likely to be so small as to be narrowly preempted. In such cases precautionary measures should be taken to keep a portion of the supply beyond control by existing producers. One possibility would be to establish limits upon the amount of reserves that may be held by a particular company. The nature of such limits would necessarily vary from industry to industry, but in a given industry they might reasonably take the form of a rule-of-thumb relationship to expected output over a stipulated number of years. Other relevant considerations in establishing such limits would be the amount of reserves which the limits would leave free for future acquisition and the effect of the limits upon efforts to discover new reserves. In some cases it would be desirable for the government to acquire and hold a portion of the reserves, to be made available for private exploitation at a later date, and for the government to undertake some of the explorations in which new reserves are sought.[20] Such plans are already in use with reference to forest lands and petroleum resources, for the government now owns substantial reserves of each. Extension of existing practice would consist merely in using such techniques more systematically and in making the availability of future supplies for potential competitors a ground for decision to act.

The policy toward exclusive-dealing arrangements which has already been suggested in connection with the use of such arrangements for coercive purposes[21] would also help to prevent preemption of market channels in ways that injure newcomers. It should be supplemented by policies designed to prevent integrated concerns from controlling inherently monopolistic transportation facilities and, where such con-

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concentration of control over such leaseholds. Similar limitations apply to the leasing of Federal lands containing phosphates, oil and gas, oil shale, and sodium.

20 Under the mineral leasing laws, more than 24 million acres of the public domain have been withdrawn for examination and classification for coal; almost 5 million acres for oil; 2 million for phosphate; 9 million for potash; and 6 million for oil shale. About one-half of the production of petroleum from public lands is performed under a "cooperative" or "unit" system of development, rather than competitive operation, to conserve resources. See statement of Harold L. Ickes, Secretary of the Interior, before the Senate Committee on Public Lands and Surveys, *Hearings*, S. Res. 53, 77th Congress, 1st Session, 1942, Part I, pp. 10-11.

21 See pp. 175-176.

trol cannot be prevented, to regulate the nature of its use. These, too, have already been discussed.[22]

Preemption of technology by the separate action of established concerns which do not pool their technological resources is a special problem. Theoretically the available technological alternatives are probably never fully exhausted by discoveries already made. In practice, however, discovery of new methods may take too long and cost too much to be practicable. Moreover, the productive possibilities of technological discoveries when pooled are often so great, and always so unpredictable until the pooling takes place, that there is strong argument for such pooling as an aid to industrial progress, quite apart from its bearing upon the problem of entry. Consequently, the basic policy should be to avoid this particular form of preemption by using all practical means to promote the exchange of technology, both among members of the industry and with newcomers. In so far as such exchanges cannot be brought about, we must accept a hazard that the newcomer may be frozen out by denial of access to the various technological methods of the various established enterprises; for the alternative would be to destroy much of the incentive for established concerns to improve their technology. But the size of this hazard can and should be reduced by extensive programs of public research, the results of which should be made available to all comers.[23]

[22] See pp. 172-173, 195-196.

[23] Before the war, between 300 and 400 million dollars a year were spent in the United States on scientific research, and the government provided about one-fifth of these funds. During the war, the government provided more than three-quarters of a total of about 800 million dollars a year (exclusive of funds spent on atomic research). From 1940 to 1944, the government spent nearly 2 billion dollars on research and development. Of this sum, about one-half went to private industrial laboratories in the form of contracts. More than 90 per cent of such contracts resulted in the ownership of patents by the contractor, while the government received a royalty-free license for its own use. See Smaller War Plants Corporation, *Economic Concentration and World War II,* a report to the Special Committee to Study Problems of Small Business, Senate Committee Print No. 6, 79th Congress, 2d Session, 1946, pp. 51-53. As of July 1, 1946, the War and Navy Departments had authority to enter into long-term research projects requiring over 500 million dollars. A *Staff Report* to the Monopoly Subcommittee of the House of Representatives Committee on Small Business states: "It is our understanding that research contracts being negotiated are, so far as patent rights are concerned, similar to those negotiated during the war program. All kinds of business, big and little, contribute through taxes toward this research, yet the patents and know-how resulting from this research are not made available to industry generally." House of Representatives Committee on

Entry and Access

Encouragement of an interchange of technology is a problem so intimately associated with the nature of monopolistic rights over technology, as established in our patent system, that discussion of it will be included below in the discussion of patent policy.

LEGAL BARRIERS

Legal barriers to entry into an industry or access to a market take five principal forms:

1. Monopoly based upon an exclusive franchise.
2. Requirements that those engaged in an industry must possess or must not possess specified characteristics or qualifications.
3. Regulations that discriminate against nonlocal enterprises.
4. Requirements that newcomers obtain licenses or certificates of convenience and necessity. Such requirements are often accompanied by and used to enforce requirements as to the characteristics or qualifications of the enterprise.
5. Grants of exclusive rights over products, technological processes, resources, or facilities that are important or necessary to particular industrial activities.

The Exclusive Franchise

The exclusive franchise is usually employed only in the case of natural monopolies and is usually accompanied by broad provisions for public regulation of the activities of the franchise holder. For the most part, therefore, this type of restriction on entry lies outside the field of competitive policy. Exceptions are to be found in the public policy of other countries. Cuba, for example, seeks to encourage the establishment of new industries by granting exclusive rights to the first comer for a stated period of years without imposing regulations upon the business policies of the monopoly thus created.[24] In the petroleum industry and to a lesser extent in other extractive industries, various countries have granted from time to time exclusive rights of exploration or of production.[25] In so far as any similar instances appear in the United

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Small Business, *United States versus Economic Concentration and Monopoly,* Washington, D.C., Dec. 27, 1946, p. 41.

[24] See Corwin D. Edwards, *Varieties of Patent Legislation,* U.S. Department of State, June 15, 1944 (mimeo.), pp. 7-8.

[25] *E.g.,* in the Middle East in 1944 the exclusive right to develop Iraq's oil fields was owned by the Iraq Petroleum Company, which also possessed an exclusive con-

States, a competitive policy would demand either that the monopolistic grant be abandoned or that a substitute for competition be provided by establishing governmental control similar to that over public utilities.

Laws about the Quality of Persons or Products

Requirements concerning the characteristics of those who engage in an industry are supposedly designed to protect the public interest by excluding persons who are incompetent or unreliable. So far as this is actually the purpose and the effect, a competitive policy must accommodate itself to the limitations upon entry which are the consequence of such requirements. There is no ground to cavil at the exclusion from medicine or law of persons who have not undergone a long course of training and a suitable examination as to proficiency. So long as national states regard preparation for war as a major part of policy, exception may not be taken to requirements that concerns which produce implements of war or render international communication or transportation service shall be predominantly domestic in management and ownership. Affirmative requirements of competence where the buyer is unable to detect incompetence are consistent with the objects of the competitive policy and are useful supplements to its methods. Protection of national strategic interests is an inevitable ground for exception to the competitive policy.

Uncertainties and disagreements as to appropriate standards of admission into an industry may result in disputes as to whether or not particular groups should be admitted. In most cases such disputes are fomented and intensified by the organized pressure of rival interest groups, of which some desire to gain admission and others to exclude newcomers. Thus a competitive political struggle among private in-

cession for the development of oil in the sheikdom of Qatar. Saudi Arabian oil fields and the Saudi Arabian part of the Saudi Arabian–Kuwait Neutral Zone were under exclusive concession to the Arabian-American Oil Company. The latter also had exclusive rights to develop the oil fields of the island of Bahrein in the Persian Gulf. In the sheikdom of Kuwait, the Kuwait Petroleum Company, owned equally by the Anglo-Iranian Oil Company and the Gulf Exploration Company (owned by Gulf Oil Corporation), had exclusive concession to oil in Kuwait. See Herbert Feis, *Petroleum and American Foreign Policy,* Commodity Policy Studies No. 3, Food Research Institute, Stanford University, March, 1944, pp. 31-35. See also Special Senate Committee Investigating the National Defense Program, *Report of Subcommittee concerning Investigations Overseas,* Sec. I, "Petroleum Matters," 78th Congress, 2d Session, Report No. 10, Part 15, Feb. 16, 1944, pp. 11-12, and Appendix VI, pp. 71-76.

terests helps determine the possibilities of entry. Conflicts of this kind have been apparent about such questions as whether or not osteopaths should be allowed to practice their profession, whether or not real-estate agents should be allowed to draw up rental contracts without the intervention of lawyers, and whether or not druggists should be allowed to compound and sell simple remedies without prescription.

Where such issues arise, standards of admission should be made as liberal as is consistent with protection of the interests of the consuming public, and no restriction should be imposed in order to protect one group of producers against the competition of another. However, each producing group will necessarily retain the right to point out dangers to the public in admitting other producing groups, and the possibility that the government and the public will be misled by deceptive propaganda from special interests is inherent in the political process.

Whereas formal requirements which exclude competitors from an industry are confined to relatively few occupations,[26] indirect means of accomplishing this end are more widespread and, in the aggregate, more important. Concerns may be indirectly excluded by smuggling into the standards which regulate an industry provisions with which some of those who desire to do business cannot reasonably comply. Regulatory procedures may be set up in such a way that those who administer the regulations have arbitrary power to shut out certain enterprises. The intent to exclude may be apparent neither on the face of the statute nor in the forms of administration, but only in the complaints of those who are excluded. Where such a system has prevailed long enough for its effects to be obvious to those who are subject to it, there are likely to be few attempts to break into the industry and hence few complaints which dramatize the restriction.

Industries to which codes of safety or sanitation are applied by public authority are peculiarly subject to restrictions of this type. There are many regulations that ostensibly control characteristics of a product or service but in fact establish substantial preferences for

[26] The Marketing Laws Survey publication, *State Occupational Legislation*, Department of Commerce, Washington, D.C., March, 1942, distinguishes twenty-four major occupations subject to statutory regulation; namely: abstracters, accountants, architects, attorneys, barbers, beauticians, chiropodists, chiropractors, contractors, dentists, embalmers, engineers, massage operators, medical technicians, midwives, naturopaths, nurses, optometrists, osteopaths, pharmacists, photographers, physicians, surveyors, and veterinarians.

certain groups of businessmen by imposing substantial handicaps upon some of their competitors. Thus sanitary laws have been invoked to make it impossible for drugstores to freeze their own ice cream; to give restaurants the exclusive right to sell food for consumption on the premises; and to prevent anyone but a registered pharmacist or druggist from selling Epsom salts, iodine, witch hazel, peroxide of hydrogen, Ex-Lax, and bicarbonate of soda.[27]

The most striking cases of exclusion from the market are found in the construction industry. Here exclusion may take place through the provisions of building codes and fire laws and through the discriminatory acts of building inspectors. Examples chosen from this field will serve for illustration.

One of the purposes of a building code is to make sure that structures will not collapse because of insufficient strength or faulty construction. To this end, the floors and walls of various types of buildings should be capable of bearing specified minimum loads, including not only the load that will actually be carried but also a margin for safety. Conformity with load-bearing requirements can be tested, but often not easily; and in practice most building codes specify the dimensions and composition of the load-bearing parts of a building rather than the loads which must be borne. In a frame dwelling, for example, there may be minimum dimensional requirements for beams and joists. Such requirements have served a purpose as guides for building contractors; but in recent years they have also been sometimes used as devices to prevent intrusion of prefabricators into residential construction. In the ordinary house the wall surfaces are hung from the structural members, so that their weight adds to the load which must be carried, while their strength adds nothing to the load-bearing capacity. In some forms of prefabricated housing, walls consist of rigid panels, in which the plywood sheets that form the wall surfaces help the structural members to carry the load. With such panel construction, load-carrying capacity is substantially increased, so that dimensional requirements appropriate to other forms of construction become excessive. By applying the dimensional requirements of building codes rigidly to prefabricators and by refusing to modify these requirements, public offi-

[27] Irvin W. Silverman, L. T. Bennett, Jr., and Irvin Lechliter, "Control by Licensing over Entry into the Market," *Law and Contemporary Problems*, Vol. 8, No. 2 (Spring, 1941), p. 249.

cials may harass prefabricators and even exclude them entirely from certain markets.[28]

Another purpose of building codes is to provide enough fire protection to give reasonable safety to the inhabitants of a building and to protect the community against conflagrations. Some of the regulations which serve this purpose prescribe minimum fire-resistant qualities for walls, floors, and ceilings. These requirements could be, and in some cities are, expressed in a form that would make it possible for a builder to use any construction material capable of meeting a standard fire test for a stated length of time. In other cities, however, the regulations merely authorize the use of materials specified in a list which is incorporated in the code. The effect is to forbid the use of any building material, no matter how fire-resistant, that has not been included in the list. In Chicago the building code discriminates in this way against producers of various types of composition wallboard which are substitutes for lath and plaster.[29]

[28] The erection of three Gunnison prefabricated houses was protested for alleged violation of Section III of the Montgomery County, Maryland, Building Code of 1928. Requirements as to allowable stresses for timber and spans for floor and roof joists were satisfied, but it was alleged that the construction violated a strict reading of the framing requirements for timber construction. Gunnison argued that the houses did not exceed allowable stresses; that the intent of the code was that stresses should govern and that specifications should be guides and not limitations; that the houses were as strong as or stronger than ordinary houses; and that either the houses complied with the code or else the code set unreasonable standards. Permits were finally issued on substantial evidence that the houses were structurally safe. Gunnison Housing Corporation, *Legal Approach in Securing Building Permits for Gunnison Housing* (mimeo.), undated.

[29] The Chicago building code, as revised in 1937, was so drafted as to require the use of lath and plaster instead of plaster board, insulation board, hardboard, and similar substitutes. The technical committee appointed by the city to work on the code had proposed that various portions of various types of structures be required to have appropriate resistance to fire as determined by standard fire tests. Thus any commodity that met the test would have been eligible for use. As adopted, however, the code required that designated materials be used, designated thicknesses be maintained, and designated methods of construction be employed. The use of hardboard for various interior purposes was made illegal by merely omitting the product from the list of accepted materials, and the code has been interpreted as though materials not specifically named are prohibited. According to a Chicago consulting engineer, the actions of the council as reflected in the code "represented ideas of individual corporations, and also labor unions." See *Building Codes Revision to Lower Costs,* Construction Industry Conference, Washington, D.C., Dec. 4-5, 1940, p. 18.

Apart from the restrictive provisions of local building codes there is a substantial handicap to the new enterprise, new product, or new method of construction in the uncoordinated variety of building regulations. Most building codes are adopted locally without attempt to make them uniform with codes prevailing elsewhere. Even a metropolitan area may be subject to a dozen different building codes adopted by the governments of the central city and the surrounding incorporated suburbs. The national market is subject to a much larger number. Within these codes many contradictory regulations prevail as to any single subject, such as the specifications for plumbing installations or the fire-resistant properties of structural materials. To produce standardized parts for construction or to engage in construction throughout a wide area is made inherently difficult by the diversity of the local laws.[30] To introduce a new product or a new method of construction is often to incur the necessity of persuading a large number of local building authorities to modify their various local codes.

A similar condition is likely to prevail wherever an industry is subject to detailed local regulations. Innovation requires not only pioneering in business but political lobbying on a large scale.

Laws against Nonlocal Business

Regulations that are designed to reserve local markets for local businessmen are peculiarly prevalent. They are relatively easy to enact because the government which adopts them is directly exposed to the pressures that local economic interests can exert and is relatively uninfluenced by the point of view of competing groups which lie outside its borders. Thus exclusion of outside traders is politically safe and popular except in the rare case in which local buyers insist upon access to the outsiders. Consequently, barriers against the foreigner abound in state and national laws.

Such regulations are seldom wholly candid. The frankest are the tariffs and embargoes which nations erect against imports from other

[30] In different codes the required working stress of structural steel differs from 16,000 pounds per square inch to 20,000 pounds; the live load which must be borne by a floor in a dwelling ranges from 40 pounds per square foot to 100 pounds; the thickness of concrete fireproofing which is required for structures which must withstand a 4-hour fire test varies from 1½ to 5 inches; the minimum thickness of permanent walls in two-story masonry buildings varies from 8 to 16 inches. See Howard P. Vermilya, "Building Codes: Administration versus Techniques," *Journal of Land and Public Utility Economics*, May, 1941, pp. 131-132.

nations. Most tariff legislation is avowedly designed to maintain barriers to trade. Within a single country, however, trade-barrier laws are necessarily more indirect, for a national government will seldom tolerate the deliberate disruption of its domestic market by local trade-barrier legislation. In the United States the Federal Constitution supposedly guarantees the right of the citizens of any state to treatment in other states equal to that accorded to citizens thereof.

Hence domestic trade-barrier laws in the United States invoke a wide variety of devices, many of which are designed to conceal their true purposes. States impose taxes and licensing systems which handicap business that is domiciled elsewhere.[31] They discriminate against producers from other states in applying inspections and quarantines which are supposed to assure the public safety.[32] They provide by law that in award of public contracts local contractors shall be given a preference over foreign contractors.[33] Cities maintain their own discriminations through taxes, inspections, and licensing,[34] and sometimes

[31] For example, Georgia taxes domestic wine containing not more than 14 per cent alcohol at the rate of 5 cents a gallon but taxes foreign wines of the same alcoholic content at the rate of 40 cents per gallon. In Washington, the wholesaler of domestic wine must pay $50 for an annual license, while the wholesaler of foreign wine must pay $250 for his license. See S. Chesterfield Oppenheim, "The Nature and Extent of State Trade Barrier Legislation," *Proceedings of the National Conference on Interstate Trade Barriers,* Council of State Governments, Apr. 5, 6, 7, Chicago, 1939, pp. 24-25.

[32] For example, in Colorado, any article brought into the state which "may be" or is "liable to be" injurious to agriculture may be destroyed or shipped out of the state. The state entomologist has broad powers to declare quarantine both within and outside the state (Colorado Stats. Ann., 1938; Supp. Ch. 803). In Wisconsin, the state entomologist must be notified of the arrival of foreign shipments, which are held unopened pending inspection (Wisconsin Stats. 1937, 94.58). See "Comparative Charts of State Statutes Illustrating Barriers to Trade between States," *Marketing Laws Survey,* Works Progress Administration, Washington, D.C., May, 1939, pp. 56-61.

[33] For example, in Maine, contracts for state, county, city, and town buildings and public works must give preference to resident workmen and bidders [Me. Rev. Stat. (1930) Ch. 54, Secs. 41, 42, p. 839; Laws, 1933, Ch. 238, p. 387]; in Missouri, the state purchasing agent must give preference to Missouri firms when quality and price are approximately the same [Rev. Stat. (Supp. 1937), Sec. 12, p. 1433]; and in Oregon, preference must be given to Oregon concerns in contracts for public works if the price is less than 5 per cent higher. [Ore. Code Ann. (1930), Vol. 3, Sec. 67-1103, p. 5133]. See "Comparative Charts of State Statutes Illustrating Barriers to Trade between States," *Marketing Laws Survey,* pp. 84-88.

[34] In Palo Alto, Calif., for example, an ordinance required a monthly inspection of all laundries selling laundry service in the city and charged a fee of $3 plus 30

go so far as to prohibit frankly the operations of itinerant vendors.

It is often possible to conceal these discriminations in an apparently nondescriminatory rule. For example, states in which the dairying industry is strong have enacted laws imposing prohibitive taxes and license fees upon the sale of margarine. The obvious point of the taxes is to prevent producers of butter from being exposed to competition from a substitute product made from vegetable oils and fats which are produced in other states. Some of the cattle-raising states have adopted a similar tax upon margarine that is not made from animal fat.[35]

Shortly before the war, certain cities, notably Dayton, Ohio, St. Louis, Mo., and Birmingham, Ala., adopted laws to exclude plumbing fixtures sold by mail-order houses through a requirement that every fixture installed within their jurisdiction must carry a sticker giving the name and address of the vendor and that every vendor must file a weekly report showing the address of each buyer. Ostensibly the purpose of the ordinances was to forestall theft of fixtures from houses under construction and to prevent installation of bad fixtures which are a menace to health. In fact, however, the laws were enacted as a result of pressure by local plumbing contractors, who felt confident that the paper work involved would not be feasible for mail-order houses and other nonlocal sellers. The courts have not supported these "sticker" ordinances.[36]

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cents for each mile to and from the place inspected. The inspection fee for a laundry 20 miles away was thus $15, while laundries within the city paid $3. The ordinance was rejected by the court on grounds of exorbitancy and discrimination between nonresident and local concerns. *Ex parte Blois,* 176, p. 449 (Cal., 1918).

[35] "On margarine made from domestic fats and oils only, ten states impose a manufacturer's annual license fee of from $5.00 to $1,000, fourteen states impose a wholesaler's annual license fee of from $3.00 to $500, thirteen states impose an annual retailer's license fee ranging from $1.00 to $400, nine states impose a tax on all margarine sold of from 5 to 15 cents per pound. Wyoming, Nebraska, and Minnesota, cattle-producing states, tax at from 10 to 15 cents per pound all margarine sold within their borders made from other than animal fats." See Paul T. Truitt, "Interstate Trade Barriers in the United States," *Law and Contemporary Problems,* Vol. 8, No. 2 (Spring, 1941), p. 213.

[36] The St. Louis law was passed in 1936. In 1937 the ordinance was declared unconstitutional and the city was permanently enjoined from enforcing it (*Mound City Plumbing Supply Company et al. v. Bernard F. Dickmann, Mayor of the City of St. Louis et al.,* Division No. 3, St. Louis, Mo., decision April, 1937). In Dayton, Ohio, the ordinance also resulted in prosecutions of concerns that sold plumbing fixtures without installing them. One case resulted in a judicial decision invalidating the

Discriminations against nonlocal business may be concealed in the methods that are used to administer an apparently nondiscriminatory statute. Some years ago the state of Florida enacted a statute that required the inspection of cement, on the theory that minimum standards of quality are essential to the safety of those who use cement structures. Simple and expeditious methods of inspection were made available for Florida's cement manufacturers. In the case of cement imported by water, however, the inspection which was provided took nearly a month, so that prohibitive charges were incurred for storage at the docks before the shipments were allowed to enter the state. The Supreme Court of the United States found that the statute was an effort to exclude foreign products under the pretext of protecting domestic consumers. The statute was declared unconstitutional in that it invaded the powers of the Federal government over foreign commerce.[37]

Some of the most prevalent and important barriers against outside competition are those that have been incorporated in the sanitary requirements applicable to urban milk supplies. In some cases these requirements include specific prohibitions upon the sale of milk from outside the state or from outside a designated milkshed.[38] More fre-

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ordinance as unreasonable (*City of Dayton v. Ralph Bohachek,* Court of Appeals of Montgomery County, Ohio, decision Jan. 10, 1938). Thereupon the city council passed an amended ordinance eliminating a provision which made possession of plumbing fixtures without stickers prima facie evidence that the law had been violated. A new case against the Direct Plumbing Supply Company and Sears Roebuck resulted in a finding by the Ohio Supreme Court that the new ordinance was unconstitutional (*Direct Plumbing Supply Company, Inc. et al. v. the City of Dayton et al.,* 138 Ohio State Reports 540). In Birmingham, the enactment of a similar ordinance was followed by a prosecution of the manager of the Sears Roebuck store and two plumbers who installed Sears Roebuck fixtures. The case resulted in a verdict of not guilty (*City of Birmingham v. L. L. Doughton et al.,* Recorder's Court, Division No. 1, Decision June 22, 1938).

[37] *Hale v. Bimco Trading, Inc.,* 306 U.S. 375 (1939).

[38] In New Mexico, out-of-state dairies must obtain a permit from the dairy commissioner to ship into New Mexico. [Laws Ann. (1929), Sec. 125, p. 1531.] In New York, such permit will only be granted by the commissioner of health on the basis of his own inspection of cows, barns, stables, milk houses, water supply, milk equipment, utensils, and milk. (McKinney's Cons. Law, Book 44, 1938 Supp., Art. 2, Sec. 6c, p. 16.) The milk control laws of Alabama, Connecticut, Florida, Georgia, Indiana, Massachusetts, New Hampshire, New York, Oregon, Pennsylvania, Utah, Vermont, and Virginia establish marketing areas, fix prices, and give broad powers to a board. In Massachusetts the board must specifically designate states or areas for additional milk supply, where Massachusetts inspection standards must be met

quently, however, the rules merely require that the milk shall come from sources that satisfy the sanitary requirements of the state or municipal milk code. States and large cities maintain their own systems of inspection to assure compliance with their standards. Cities and states typically refuse to allow milk to be sold if it does not come from sources that have been approved by their own inspectors. Thus refusal to inspect milk offered by any supplier automatically excludes that milk from the market, and establishment of the area within which inspections will be made automatically defines the area from which the milk supply can be drawn.[39] The inspection system often has the effect of preventing the market for milk in one city from being affected by a surplus available in another city.

In principle, provisions designed to exclude concerns from an industry or a market should not be allowed to masquerade as parts of a system of regulatory safeguards. However, this principle is hard to apply. The complexity and technical character of many regulations are so great that the general public cannot readily detect perversions, whereas interest groups can easily formulate plausible restrictive provisions. Under any system of regulation that depends upon inspection, the inspector necessarily has a wide discretion which gives opportunity for abuse. The integrity of the public agency that administers the regulations is likely to be hard to maintain. Moreover, many of the most complicated and potentially dangerous regulatory systems are administered by local governments, which notoriously are more easily swayed by private inducements than the Federal government.

Nevertheless, progress can be made along four lines toward protecting newcomers against such abuses. First, the quality of inspectors should be improved in order to diminish their abuses of discretion. This would entail such steps as selection of inspectors, so far as possible, from groups having no direct interest in the industry; use of a

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[Laws Ann. (1932), Ch. 94, Sec. 16H]. See "Comparative Charts of State Statutes Illustrating Barriers to Trade between States," *Marketing Laws Survey*, pp. 22-29.

[39] In Connecticut, no milk from any dairy outside the state may be sold within the state unless the dairy has been inspected by the Connecticut milk commissioner at the dairy's expense (within the state, inspections are at state expense), and the commissioner is not authorized to inspect dairies beyond the natural or present milk-shed of the state except in extreme shortage or emergency. (G.S. 1930, Secs. 2488, 2489, as amended; Laws 1935, Secs. 951c, 952c, 956c, 957c, 959c). See "Comparative Charts of State Statutes Illustrating Barriers to Trade between States," *Marketing Laws Survey*, pp. 22-23.

merit system of selection; permanent tenure of office; adequate compensation on a full-time basis; encouragement of the establishment of inspectors' associations to formulate professional standards of inspection; and establishment of appeals machinery to deal with charges of arbitrary or corrupt action.

Second, regulatory standards should be stated, so far as possible, in terms of performance. For example, fire-protection laws should specify fire tests rather than the substance of building materials, and structural requirements should be stated in terms of load-carrying capacity rather than dimensions. Where characteristics other than those of performance are used for convenience, machinery should be provided by which anyone desiring to enter the industry may obtain modification of these characteristics upon showing that performance would not be thereby impaired.

Third, active steps should be taken to make localized regulations more uniform. In part, this can be done by formulation of standard regulatory codes suitable for adoption in various localities. In part, it can be done by conferences of regulatory officials looking toward elimination of discrepancies in their respective codes. In part, it is possible through local reliance upon standards and tests that are developed on a basis broader than a single locality. For example, local building codes might provide that not only local tests but also tests conducted by the United States Bureau of Standards or some other appropriate national or state agency shall be adequate to determine the fire-resistant or load-bearing qualities of a building material.

Fourth, safeguards should be provided against arbitrary action by regulatory authorities. It is already possible for state and municipal regulations to be set aside in the Federal courts because of their restrictive effect upon interstate commerce. The regulatory power of municipal and state governments should be more clearly limited under state laws to proper public purposes, and the exclusion of competitors from an industry for the benefit of those already admitted should be clearly defined as an improper purpose. The authority of state courts to review regulations in the light of such a standard should be made clear. A state administrative agency competent to consult with local governments as to restrictive features of local regulations, to recommend means of removing restrictions, and to institute proceedings in the courts against unreasonable restrictions would be an appropriate part of such a program. Similarly the present function of the Federal courts in protecting the freedom of interstate commerce should be ex-

tended and supplemented by administrative action. To this end Federal administrative officials should be empowered to proceed against state and local restrictions that impose unreasonable burdens upon the government as a buyer of materials and services and to withhold Federal grants-in-aid where unreasonable state or local restrictions would result in undue waste of Federal funds. A Federal agency should be authorized to review the restrictive features of state and local regulations and to cooperate with state and local governments in formulating general standards and model laws through which such restrictions can be avoided. So far as possible, state and local restrictions that unreasonably restrain interstate commerce should be attacked by the law officers of the Federal government in the Federal courts; and to this end it would be appropriate for Congress to enact a statute defining types of restrictions by public bodies that are regarded as unreasonable interferences with commerce.

License Requirements

Laws which require that members of an industry must be licensed or must obtain public certificates of convenience and necessity are often adopted as devices to enforce regulatory standards such as have been discussed in the last few pages. Where the regulations have been suitably limited to proper public purposes, the existence of a licensing requirement designed merely to enforce these regulations is likely to make administration more effective without introducing new restrictive elements. It is noteworthy, however, that in so far as the regulations themselves may have been perverted to private ends, their restrictive effect is enhanced by a licensing system, as it would be by any other device that would assure their more complete enforcement.

In some cases, however, systems of licensing have been developed apart from substantive rules applicable to the competence or performance of members of the industry. The purpose ostensibly served by such licensing systems is usually to protect an industry from invasion by so many enterprises that business would become generally unprofitable. In other words, the typical intent is to protect the profits or at least the solvency of concerns already established. In some cases there are subordinate purposes to exclude new types of enterprise and new ways of doing business and to guarantee the continuance of traditional methods. Where such a secondary purpose exists, exclusion of the newcomer is often said to be necessary in order to protect the

quality of the industry's product and thus to safeguard the industry's customers. That such assertions are disingenuous is usually evident from the fact that other and more obvious threats to quality are ignored and that more direct methods of maintaining quality are not used even though available.

An example of this use of licensing laws is the North Carolina statute that requires tile contractors to obtain state licenses. According to spokesmen for the organized North Carolina contractors, the law was written and lobbied through the state legislature by their organization. Its purpose was to prevent installation of tile by general contractors, who had begun to do the job without subcontracting; by other subcontractors, such as brick masons, whose business could be extended to include tile work; by self-employed artisans, who had no established place of business; and by ultimate consumers who, personally or through their architects, might supervise the installation of tile on their own premises. The effort to shut these persons out of the industry was defended on the theory that the quality of their work was inferior. Under the statute all regular tile contractors in business in the state were granted a license without examination, and an examining board composed entirely of members of the association was set up to consider further applications. During the first year this board rejected all applications which it received.[40]

A similar effect is sometimes produced by extending the application of a licensing law which, within its legitimate field, is reasonably associated with enforcement of standards of competence. It is generally recognized, for example, that plumbing systems may be dangerous to health unless they are installed by competent persons, and in consequence the requirement that plumbers be licensed is common. The licensing requirement often extends not only to the journeyman who performs the job but also to the master plumber who plans the installation and directs the work. For the purpose of this discussion, the propriety of such requirements will be presumed. In the plumbing trade, it has been customary for plumbing equipment to be sold at re-

[40] The public report from which this abstract was prepared was made at a convention of the national association (Tile and Mantel Contractors Association of America) about a year after the law went into effect. Two examinations for new applicants had been held during the year. Information is not available as to the board's subsequent record. See N.C. Gen. Stat. (1943) Secs. 87-28*ff*. See also Corwin D. Edwards, "Legal Requirements That Building Contractors Be Licensed," *Law and Contemporary Problems*, Vol. 12, No. 1 (Winter, 1947), pp. 77*ff*.

tail through master plumbers who refuse to sell it except upon an installed basis, and in recent years this custom has been jeopardized by the appearance of mail-order houses and other establishments willing to sell fixtures to any buyer. In some municipalities the requirement that master plumbers be licensed has been used to attack the new system of distribution by an interpretation of the term *master plumber* so that it includes not only the person who plans and directs an installation but also any person who retails any plumbing equipment.[41] The effect of such an interpretation would be to make entry into the retail plumbing business conditional upon ability to pass an examination as to how plumbing should be installed, and ordinarily to leave the giving of the examination to officials who, having spent years as master plumbers, are prejudiced against the new distributive methods.

Abolition of certain licensing requirements and provision of substantial safeguards for those retained is desirable in order to protect freedom of entry. A licensing requirement that is designed to protect established businessmen against newcomers is a perversion of public power. Even on the assumption that there is a public interest in limiting the intensity of price competition—an assumption contrary to the presuppositions upon which this volume is based—there is little excuse for use of a method that systematically protects vested interests by reducing business opportunities. The legitimate field for licensing is only that in which the public interest requires the exclusion of persons who do not meet certain standards.

Moreover, even licensing to protect the public interest should be a final resort after it has become clear that other devices are insufficient. The public interest in the quality of goods, for example, is general throughout industry, but the licensing of all business is not suggested as an appropriate way to protect this interest. Incompetent persons should be excluded through a licensing system only where neither competition nor supplementary rules designed to require disclosure of quality can provide protection for the consumer, and where failure to protect him would jeopardize public health or some other substantial social objective. Even on the assumption that ways cannot be found to enable the public to buy tile competently, it is questionable whether the public interest in the quality of tile installations is great enough to justify a governmental veto upon entry into this field of business.

[41] *Ibid.*, p. 84, and Corwin D. Edwards, *Restraints in Building Codes,* Central Housing Discussion Papers, G: 1940 Series, pp. 4-5.

Where licensing systems are appropriate under the standards just suggested, care should be taken to make them serve public rather than private purposes. To this end at least three safeguards should be provided. First, the objectives of the licensing program should be clearly incorporated in the law, and those responsible for issuing licenses should be required to base their decisions upon standards appropriate to these objectives. Under no circumstances should the licensing agency have broad authority to issue or refuse licenses on grounds not clearly defined. Second, decisions about licenses should be based upon a procedure designed to make unfair action difficult—examination, written statement of grounds for rejection of an applicant, and opportunity for appeal. Licensing authorities should not have the type of discretion that permits some of them to use trick questions in examining certain applicants, to withhold a public statement of their reasons for rejecting applicants, and to avoid review of their findings by higher authority. Third, licensing officials should be selected for their impartiality. They should have no connection with any interest group whose interests are affected by their decisions.

Limits upon Access to Resources

The most common legal obstacle to entry into an industry is exclusion by the government from the right to use a technological process, resource, facility, or invention. Occasionally such exclusions are brought about by grants to certain enterprises of rights, withheld from others, to use public property or to operate on the public domain. Thus certain lumber companies may be allowed to cut timber in national or state-owned forests, certain oil companies may be allowed to extract petroleum from publicly owned reserves, and certain potash producers may be given leases of Federal potash lands. Unless a fee is exacted which adequately offsets the capital costs and maintenance charges which excluded concerns would have to incur to obtain similar facilities from private sources, such preferences amount to a subsidy for the preferred concerns. Such an advantage may be great enough to be decisive in excluding others from the industry. If resources are scarce, the preferred concern enjoys a preferential right to exist, whether or not it pays a reasonable sum for the privilege.[42]

[42] In 1940 the United States Potash Company had Federal leases covering potash rights in 15,323 acres and state leases covering 32,660 acres; it had also acquired title in fee to 160 acres. The Potash Company of America had Federal leases to 15,360

Precautions should be taken against creating such preferences. Where public resources are to be privately exploited, a procedure of competitive bidding should be used in awarding the rights of exploitation in order that every competitor may have a chance to acquire them and in order that fees may be high enough to be fair to competitors of the successful bidder. Where resources are so scarce that unsuccessful bidders are likely to be excluded from the industry, consideration should be given to limitation of the size of the grants in order to avoid creating monopolies; and where such a policy is not feasible, one of the conditions of the grant should be close public supervision of its use.

THE PATENT LAWS: NATURE OF PATENT RIGHTS

The principal way in which governments exclude potential competitors from the use of technological facilities is through the operations of the patent system. A patent is a monopoly right to make some product, or use some process or design, which has been granted by a government for a limited period of years as a reward for invention. The nature and duration of the grant differs from country to country. In the United States the patent holder has exclusive rights to the invention for seventeen years from the date of the patent. During this time, whether or not he uses the invention himself, he may prevent others from using it or may grant rights of use subject to various restrictions and limitations. American patent law contains no provisions designed to enforce or encourage the use of a patent, to protect the public against onerous charges by the patent holder, or to enforce

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acres, state leases to 9,639 acres, and private leases to 240 acres. The American Potash and Chemical Corporation was owner in fee of some 3,320 acres which were at one time part of the public domain, and patent to these areas was granted the company by the Department of Interior. The company also held three Federal leases to potash rights in 5,969 acres. Some public lands have been leased for exploration to the Union Potash Company. See Willard L. Thorp and Ernest A. Tupper, *The Potash Industry,* A Report Submitted to the Department of Justice by the Department of Commerce, May 1, 1940. Three producing companies, United States Potash, American Potash, and Potash Company of America, produced and sold almost 50 per cent of the potash sold in the United States before the war; a French-German syndicate imported and sold almost 50 per cent; and the three domestic companies and the syndicate sold 99 per cent of the potash in the United States. See *United States v. American Potash and Chemical Corporation et al.,* complaint under the Sherman Act, May 15, 1940; consent decree, May 21, 1940, Southern District of New York, p. 4.

an interchange of patent rights by persons whose patents must be used together if they are to be used at all.

The theory upon which patent law is based is that the prospect of monopoly rights will stimulate an active process of invention and will induce inventors to disclose, in applications for patents, the substance of their inventions. Monopoly rights granted under patents, it is argued, are no disadvantage to the public; in the absence of a patent system, the monopolized inventions probably would not have been made or disclosed. Since the patent monopoly includes complete power to suppress the invention during the patent period, any use of the patent by the inventor, no matter how restrictive his policy may be, is a mitigation of the impact of his monopoly. Similarly, since the patent monopoly includes an absolute right to prevent use of the invention by others, a grant of a license to use is a mitigation of the monopoly regardless of the restrictions that may be attached to the license. In fostering inventions and releasing them for competitive use after a limited period of time, the patent system converts the attractiveness of monopoly into a stimulus for technological improvement and effective competition.[43]

This argument has been supplemented in recent years by a second. The process of perfecting an invention and learning how to put it to commercial use is often slow and expensive. It is contended that, unless an invention is patented, no enterprise will be willing to undertake such development because, by waiting, its rivals can adopt the perfected technique without incurring equivalent expense and can then force prices so low in competition as to prevent the pioneering concern from recovering the costs of development. On this theory technological progress would be retarded by the absence of patent monopolies even if there were no diminution in the amount of invention and disclosure.[44]

[43] See National Association of Manufacturers, Economic Principles Commission, *The American Individual Enterprise System,* Vol. II, pp. 593-594, McGraw-Hill Book Company, Inc., New York, 1946.

[44] See, for example, testimony of Dr. William D. Coolidge, then director of Research Laboratory, General Electric Company, before the Temporary National Economic Committee, *Hearings,* Part 3, p. 916. ". . . without patent protection the manufacturer would spend money on the development of a device and would put it on the market and it would then be copied by others, and the second manufacturer making the 'Chinese' copies would have no development expense and so could undersell the first manufacturer who was responsible for the device in the first place."

Whatever merit these theories may have when they are applied to the work of individual inventors in a society of small enterprises in which inventions are relatively infrequent, they do not adequately describe the impact of the patent system in a society in which large corporations maintain research departments, purchase large numbers of inventions by outsiders, and use, simultaneously and consecutively, the monopoly power given by many patents. Change of scale in the use of patents has substantially affected both the nature of the patent grant and the effect of the patent monopoly upon the market.

Concerns that are continuously engaged in obtaining and exploiting patents can afford the services of highly skilled patent lawyers. These attorneys explore the shadowy corners of the law as assiduously as research technicians investigate the frontiers of technology. Since an application for a patent consists of a series of verbal statements expressing the technological content of what has been invented, much of the patent lawyer's skill is spent in inventing formulas of words that plausibly extend the scope of the claims made in the application. As it reaches the patent office the application combines technological and legal invention, and the latter, if of superior quality, may do much to offset deficiencies in the former. To examine and deflate these highly sophisticated and carefully prepared claims, the patent office has an insufficient staff of relatively inexperienced persons who, because of the press of their work, can give to each application, on the average, only a few hours of attention.[45] In the days when the typical inventor, though technologically proficient, was legally unsophisticated, the abilities of such a staff may have been more than a match for any stratagems used by applicants for patents. Today the situation is reversed, so that both skill and careful preparation are likely to lie on the side of the applicant who seeks a monopoly rather than on the side of the officials who determine whether it shall be granted.

The tests which these officials apply are necessarily crude: Does a comparison of language suggest that the claim overlaps patents previ-

[45] Joseph Farley, patent counsel, Ford Motor Company, told the TNEC that during his earlier experience as examiner for the patent office: ". . . I was required or expected to turn out 25 to 30 actions a week. That means that I was acting on four or five cases a day, and making searches that probably were anywhere from half an hour to two hours in duration, so that it was impossible for the examiner and the efficient operation of the office purely as an administrative office to make the type of search that is necessary to really determine whether or not an idea is novel." *Hearings*, Part 2, p. 267.

ously issued or other claims already on file? On the basis of common knowledge in the relevant industrial field and of such reference works as are readily available, is there anything novel in the alleged invention, and if so, is this novelty anything more than a recombination of existing knowledge, such as might be made by any competent workman? Is there any inherent contradiction or obvious impossibility in the statement of the claim? Is the claim so stated that it obviously stretches beyond the boundaries of the alleged invention? Unless a comparison of the application with previous applications and patents and with standard works of reference disproves the originality of the invention, the nature and fact of the invention are usually judged only by the self-interested statements filed by the applicant.[46] There is no procedure by which persons who may be adversely affected by the patent may offer any relevant information they may possess to show the impropriety of the application.[47] There is no provision for proof that the invention has actually been made or that it accomplishes anything, and no provision for skilled technical appraisal of the place which the invention occupies in the developing technology of which it is a part. Still less is there opportunity to raise questions as to the

[46] In 1890, the requirement that models be submitted with each patent application was given up, due largely to space and time consumed in housing and checking the models. The patent office may require specimens "when the invention or discovery is of a composition of matter," and a model of convenient size "in all cases which admit of representation by model . . . to exhibit advantageously the several parts of his invention or discovery" (U.S.C., Tit. 35, Sec. 34). The patent office does not have laboratory facilities to test the actual operation of inventions, and the right to require models has been used in relatively few instances, e.g., the demonstration of the Wright brothers' "flying machine."

[47] The patent office alone may initiate "interference proceedings." These are for the purpose of determining who was the first inventor, in point of time, in instances where there are two or more applications for a patent on the same idea. An applicant for a patent may request that his application be put into interference with another application. The first step in the proceeding is a decision by a single interference examiner as to who made the invention first. This may be followed by an appeal to the Board of Appeals, and the decision of the latter may be appealed to the district courts or the Court of Customs and Patent Appeals. See testimony of Conway P. Coe, commissioner of patents, before the TNEC, *Hearings*, Part 3, pp. 861-862. The United States patent procedure has no parallel to the "opposition proceedings" in certain other countries, where the patent application is subject to public inspection for a period of about three months, during which anyone may make objection to the grant of the patent. Interference proceedings, in contrast, have to do only with the question of ownership of the patent. See testimony of Lawrence Langner, patent attorney, *ibid.*, pp. 1014*ff.*

economic effect of granting or denying the patent application or of enlarging or reducing the scope of the grant. The process comes perilously close to letting anyone have a monopoly, the size and shape of which he is allowed to formulate for himself, provided only that it does not overlap an activity already carried on or a monopoly already granted to someone else.

Even conflict between the claims of different applicants need be no serious obstacle in the development of a patent monopoly. Such conflicts are treated by the patent office as private controversies between the claimants rather than as issues of fact which cast doubt upon the propriety of granting either claimant a right to exclude third parties. The applicants are left free to compose their differences by private negotiation, and if one application is withdrawn the patent office will consider the other without prejudice.[48] Many such conflicts are settled by agreements to share the patent monopoly upon some basis that roughly measures the relative bargaining strength of the parties and that leaves out of account the effect of the agreement upon the public interest.[49] In opposing any publicity for patent applications prior to

[48] For example, in 1934, inventors employed by New Jersey Zinc Company and American Smelting and Refining Company were in interference proceedings in the patent office regarding applications for the fractionation process of refining zinc. The New Jersey inventors' applications related to the fractionation process only as applied to purifying zinc, and one of the applications filed by an American Company inventor related to the fractionation process as applied to the purification of metals generally. The two companies arrived at an agreement whereby American's inventors ceded priority in the interference to New Jersey's inventors and the latter filed a new and broader application related to the fractionation process as applied to metals generally. The New Jersey inventors' applications, including the new one, were granted thereafter by the patent office. The New Jersey Company then granted American an exclusive license to use the fractionation process for metals other than zinc. See Senate Committee on Patents, *Hearings* on S. 2303 and S. 2491, 77th Congress, 2d Session, 1942 (hereinafter referred to as Senate Committee on Patents, *Hearings*), Part 3, p. 1523.

[49] For example, an infringement suit by Bell Telephone Company against Western Union on an early telephone patent was withdrawn from court with the following compromise: Western Union acknowledged the validity of the Bell patents; Bell was licensed to use all the Western Union patents in the particular field; Western Union withdrew from this field; Western Union agreed to pay 20 per cent of the cost of all new patents developed or acquired by Bell; Bell agreed to pay Western Union 20 per cent of all royalties. In effect, the question of priority of patents was never settled and the competing patents were merged. See TNEC, *Patents and Free Enterprise,* Monograph No. 31, p. 88. See also testimony of Walter R. Hutchinson, special assistant to the Attorney General, before the Senate Committee on Patents, *Hearings,* Part 2, pp. 685-688.

the patent grant, patent attorneys argue that if the existence of a patent application becomes known conflicting applications will be filed by persons who wish to obtain some privilege under the patent in return for withdrawing their counterclaims.[50] The possibility of this type of blackmail reveals the looseness of the test of invention which is applied in granting a technological monopoly.

Laxity in the standards under which patents are granted can be partially defended upon the ground that decisions by the patent office are not final. A patentee can enforce his monopoly right only by suits for infringement in which the defendant is free to challenge the validity of the patent. From this point of view a patent grant by the patent office is merely a license to litigate in court the question whether or not there has been an invention.

If a patent is improperly denied, the applicant has a substantial incentive to appeal the decision. In the case of large corporations which are continuously concerned with patents, it is improbable that the opportunity for successful appeal is often overlooked. If, on the other hand, a patent is improvidently granted, there is much less likelihood of appeal. Small inventors, ultimate consumers, and even small competitors of the patentee have so diffused an interest and are so ill able to bear the expenses of litigation that they cannot be expected to challenge the grant. Large and powerful competitors of the inventor may have an adequate incentive to do so, but in such cases an appeal can often be forestalled by the patentee's willingness to grant to such powerful concerns rights under the patent. Moreover, large and small competitors alike may be willing to recognize the validity of a patent as an instrument through which prices can be fixed and other monopolistic restrictions can be imposed. In consequence invalid patents may remain unchallenged. That this is so is attested upon occasion by a court decision that nullifies a patent after years of use.[51] Much more

[50] See testimony of Lawrence Langner, patent lawyer, before the House of Representatives Committee on Patents, *Hearings* on HR. 4523, 74th Congress, 1936, Part I, p. 617: "A further disadvantage of the opposition system resides in the fact that it is an invitation to blackmail the inventor or concern owning the patent, and we are often in receipt of letters from foreign concerns . . . stating that unless they are granted a free license they will bring opposition proceedings. That is a common practice of parties."

[51] From 1929 to 1941, an invalid patent to a particular process of mineral wool production was the subject of a series of infringement suits which were designed to bring competitors into a price-fixing combination. Licenses were denied other

frequently it is evident in the conversation and correspondence of businessmen and patent lawyers, who habitually classify patents into "strong" and "weak" patents according to the probability that they will survive a test in court.[52]

Thus the patent system has become a device through which the verbal facility and negotiating skill of lawyers may be rewarded by grants of monopoly running appreciably further than would be necessary to recognize the contributions of inventors. Wherever such a patent claim is granted, the effect is either to transfer into private ownership some part of the public technological domain or else to forestall invention by giving someone a monopolistic right to inventions that have been verbally described but not yet actually made.

The legal power conveyed by a patent is sometimes supplemented by economic power derived from the possession of technological trade secrets with reference to the subject matter of the patent. Theoretically a patent is granted as an inducement for the inventor to disclose his invention. When a patented product is sold, its nature is necessarily disclosed in the sale. This is not true, however, of a patented productive process. The slipshod method of identifying inventions which has been described above makes it possible to obtain a process patent without revealing all that must be known in order to make effective use of the patented invention. Where this is done, the public does not receive the information that supposedly justifies the grant of monopoly rights to the inventor.

Instead, the patentee obtains the bargaining power attached to a legal monopoly and also continues to enjoy whatever bargaining strength he can derive from possession of a trade secret. So commonplace has inadequate disclosure become that the unpatented secret knowledge which is necessary to use a patent is colloquially called the know-how and is generally regarded as property distinct from the

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potential producers. See *Slayter and Company v. Stebbins-Anderson Company, Inc. et al.*, 117 F. (2d) 852.

[52] See testimony of Walter R. Hutchinson, *op. cit.*, Exhibit No. 22, p. 814. Correspondence collected by the Antitrust Division in the course of an investigation of methyl methacrylate, a plastic, included an interoffice memorandum of E. I. Du Pont de Nemours & Company, stating: "If the Hill patent were strong and would give us a dominating position in the field of methyl methacrylates, we might hesitate to give up that position in order to settle the other interferences on more specific products and processes. If, however, there is considerable doubt as to its validity, a settlement may be the best way of safeguarding our position. . . ."

patent to which it applies. Licenses to use patents are commonly of two types, one of which conveys merely a waiver of the patentee's legal right to exclude others from use of his invention, whereas the other conveys not only such a waiver but also a right to the relevant know-how, to be obtained by access to specifications and research reports, interviews with technicians, and inspection of the patentee's use of the patent. A license that conveys know-how is more valuable than one that does not, and customarily the licensee must pay more for it.

Methods of exploiting a patent monopoly have also been affected by the change in scale of operation under patents. Although a patent grants a monopoly, the monopoly power conveyed by a patent may not be large. So-called "basic patents," indispensable for those who would engage in some type of production, may convey a monopoly of an industry. In most cases, however, a single patent covers only an improvement in industrial technique or one of several alternative devices by which a technological objective can be reached. So long as other concerns can develop or acquire alternative patents, the holder of such a patent has little power to translate it into control of an industry. The danger created by the patent system in such cases is less one of monopoly than of stagnation. From the point of view of the public interest, the principal risk is that complementary industrial techniques will be patented by different interests and will not be used because the various patentees are unable to agree upon the joint use of their various inventions.[53]

When large numbers of patents are held by the same concern, the situation is different. Having obtained one patent that covers one way of accomplishing a given result, the enterprise may be expected to try to acquire other patents that cover all the other ways by which the same result may be obtained.[54] Once these patents are assembled, only the best is used. The rest are retained to exclude competitors from the

[53] Sidney F. Parham, patent attorney, Hartford-Empire Company, told the TNEC: ". . . to be perfectly candid I do know of one instance in which we were being more or less threatened with a very serious patent coming out on forming machines, in which we slightly delayed the issuance until we could make a trade with the man that owned the other patent." *Hearings*, Part 2, p. 459.

[54] For example, U.S. Gypsum Company has held many patents on gypsum wallboard. This product consists of a core of gypsum between two sheets of paper. The overlapping of the paper to make a closed-edge board was an improvement that eliminated chipping of the gypsum core at the edges. In 1926, U.S. Gypsum Company had thirty patents applicable to the product, including several upon alternative ways of closing the edge and one covering a machine for the manufacture

field by preventing them from using alternative processes.[55] Moreover, as larger numbers of patents are assembled, the holder acquires control over many complementary improvements in the industry's processes and products. Though the patents may be individually unimportant, in the aggregate they give control of so much of the industry that competitors could not well do without them.[56] Patent control ceases to be typically the monopolization of a particular advantage in product or in industrial process. Instead, it comes to be substantial monopolization of the industry itself.

The scale of this monopolization is extended by the fact that in large accumulations of patents the quality of the individual patent becomes progressively less important. The concern that owns a single weak patent cannot use it effectively for monopolistic purposes because any competitor can avoid control by appealing to a court. A concern that owns many patents, some of which are weak, need not worry about the validity of the weak ones. If it extends licenses, it can insist upon acceptance of the validity of its weak patents as a condition for receipt of a license under the rest of its patents.[57] If it refuses to grant licenses,

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of closed-edge board. It also owned thirty-eight applications for additional patents. See *United States v. United States Gypsum Company et al.,* complaint under the Sherman Act, District of Columbia, Aug. 15, 1940, p. 14.

[55] See testimony of Sidney F. Parham, TNEC *Hearings,* Part 2, p. 459: ". . . fencing in . . . means that from a patent sense you try to get not just the particular piece of machinery covered with a patent claim but a certain zone around that particular machine which you speak of as being fenced in as your property, and the other fellow fenced out. . . . That means that if you have a broad claim by itself it may fence in, or you may fence in by half a dozen narrower claims of different types.

"Senator Borah. So that the enemy can't spread out too much?

"Mr. Parham. So that the enemy can't break into your own little patented preserves. . . ."

See also Exhibit No. 125, "Memorandum on Policy of Hartford-Empire Company, Feb. 18, 1930," *ibid.,* pp. 778-779. Of 223 applications for patents filed by Hartford-Empire in 1927-1929, 200 were for direct or indirect protection to the company's commercial devices. Of these, 88 were for "direct protection" and 112 for "indirect protection." The latter term is defined as "applications which prevent the use or improvement of an existent or possible substitute for the device. This 'indirect protection' seeks to block competing devices which would lessen our income."

[56] For example, the Bell Telephone system in 1934 was free to use about 15,000 patents, of which about 9,500 were owned outright, the remainder representing licenses to use or make. TNEC *Hearings,* Part 3, p. 963, footnote 1.

[57] The U.S. Gypsum Company proposed in 1926 that all wallboard manufacturers in the Eastern United States become licensees under its many closed-edge board

it can prosecute infringers under as many different patents as it chooses to invoke. So long as it is in a position to bear the legal expenses, it can harass a weaker competitor by multiple suits without much regard to the question whether individual suits will be finally won or lost. In working out business alliances with other concerns that have many patents, its bargaining power is likely to be determined partly by the relative legal strength of the rival patent holdings; but by accepting the validity of weak patents held by others, each concern may induce the others to accept the validity of its own.

The change of scale in acquiring and using patents has also destroyed the effectiveness of the time limitations which are attached to patent grants. Where technology progresses slowly and enterprises are small and patents are diffused, it is reasonable to suppose that there will be active competition in using technological devices upon which patents have already expired. Under modern conditions this often fails to take place. A concern that bases its business strategy upon patents is constantly engaged in applying for or purchasing new patent rights as its old ones expire. It attempts to avoid a situation in which it no longer enjoys patent protection. If it is fortunate enough to control basic patents without which competitors cannot operate, it may keep an industry to itself for seventeen years or may admit competing concerns only under rigid limitations as to the scope of their activities. Since technology is dynamic, the patentee is likely to acquire important new patents within the seventeen-year period and to use these to perpetuate its exclusive position or the limitations upon its competitors. For a competitor to rely upon technology that prevailed more than seventeen years before, to the exclusion of subsequent improvements, may be to incur an overwhelming handicap. True, cases are on record in which the basic patents of an industry have expired and patent control has been broken; and there are other instances in which important new patents have been developed by concerns other than those that held the old ones, so that patent control has passed from one enterprise to another. Equally striking, however, are cases in which one

patents. The company proposed a contract under which each licensee would be required to admit the validity of patents already issued and to be issued later under applications then pending. Each licensee would be required to agree not to contest the validity and scope of such patents. See *United States v. United States Gypsum Company et al.*, complaint under the Sherman Act, District of Columbia, Aug. 15, 1940, p. 14.

enterprise has held control through patents for periods as long as half a century.[58]

Moreover, the expiration of patent control has not always meant expiration of the monopoly which was originally based upon patents. During the period of patent control an enterprise that dominates an industry may establish its trade-marks, develop its marketing channels, purchase most of the available reserves of raw materials, make long-term contracts with important customers and distributors, and in

[58] The General Electric Company originally obtained control over the electric lamp industry in 1892 through its ownership of the Edison patents on the carbon-filament incandescent lamp. According to the company, predominance passed to Westinghouse between the expiration of the controlling patent in 1894 and the year 1905. According to the Department of Justice, General Electric's control was continued through various other patents and through restrictive agreements which were terminated in 1911 by an antitrust decree. In 1912 General Electric Company acquired the controlling patents on tungsten-filament electric lamps. It entered into licensing agreements with Westinghouse and subsequently with other lamp manufacturers. Under these agreements the licensees were assigned quotas of production. From time to time the licenses were renewed and the quotas enlarged. In 1941 the company's dominant position in the industry was supported by more than 500 patents. In 1940 it produced about 58 per cent of the large incandescent lamps sold in the United States. The total production of the company and its licensees was more than 90 per cent of the total United States production of lamps.

In 1926 the company won an antitrust suit in which it was charged with conspiracy to fix and maintain resale prices of electric lamps through agency contracts with retailers and licensing agreements with other manufacturers. In 1941 another antitrust suit was instituted, charging that General Electric and other manufacturers combined to acquire a monopoly of patents relating to the incandescent-lamp industry and to limit production, allot territories, eliminate competitors, and fix prices. Westinghouse Electric and Manufacturing Company and Corning Glass Works signed consent decrees in this case. The lower court dismissed the case as to the other defendants. In another case, filed in 1942, the government charged a conspiracy involving the use of patents with reference to fluorescent electric lamps. Corning Glass Works accepted a consent decree, and in December, 1947, the case was still pending against the other defendants.

See *United States v. General Electric Company et al.*, Civil Action 1364, District of New Jersey, Brief for the United States dated Aug. 30, 1946, especially pp. 77-112; Brief for General Electric Company and International General Electric Company, dated Dec. 2, 1946, especially pp. 35-111; Trial Record, p. 1119. See also *United States v. General Electric Company*, Civil Action 2590, District of New Jersey; *United States v. General Electric Company*, Equity Action 1051, Northern District of Ohio (1924), 272 U.S. 476; TNEC Monograph No. 31, *Patents and Free Enterprise*, by Walton Hamilton, pp. 93-103; and *United States versus Economic Concentration and Monopoly*, Staff Report to Monopoly Subcommittee of House Committee on Small Business, Pursuant to H. Res. 64 (79th Congress), pp. 230-233.

various other ways consolidate its dominant position. When the patents expire, these other sources of power may be sufficient to forestall effective challenge of the supremacy of the dominant concern. In the aluminum industry, for example, basic patents expired about 1909, but in 1939 the Aluminum Company of America was still the only producer of aluminum ingot in the United States.[59]

THE PATENT LAWS: METHODS OF EXPLOITING PATENTS

Where the strength of a patent position is great enough to give one concern monopolistic control over an industry, the exploitation of the monopoly is similar to that of monopolies which have other origins. Limitation of output, high prices, and high profits are characteristic. But there is usually an active inventive process designed to perpetuate patent control, as well as an active process in buying up patents developed by others.[60] Thus technological progress is likely to be more rapid than under other forms of monopoly. The rate at which new technology is put to use, however, may be less rapid than is made feasible by the rate of invention.[61] If substantial amounts of capital are invested in equipment not yet fully depreciated, the patent-holding concern may develop its inventions rapidly to the point where they are patentable, but leave them in the pilot-plant stage until replacement of the old methods is convenient.[62] This form of monopoly is also

[59] *United States v. Aluminum Company of America,* 148 F. (2d) 416 (1945).

[60] The General Electric Company's annual budget for its central research laboratory is about 1 million dollars. See testimony of Dr. William D. Coolidge, former director of the General Electric Research Laboratory, TNEC *Hearings,* Part 3, p. 915.

[61] In addition to the commercial incentives to retard the use of inventions which are here discussed, there are sometimes political incentives. Patents in one country may come directly or indirectly under the control of the government of another country, and may be partially or wholly suppressed in the pursuit of national political advantage. See Corwin D. Edwards, *Economic and Political Aspects of International Cartels,* pp. 58-61.

[62] General Electric Company, Westinghouse Electric and Manufacturing Company, and certain other manufacturers have been charged with having conspired with public-utility companies to retard the introduction of fluorescent lighting in an attempt by the dominant manufacturers to strengthen their control of the new development, and by the public utilities to prevent a reduction in the amount of electric current consumed. Although at the close of 1947 the charge had not yet been tried, business correspondence purporting to show the conspiracy had been made public in Congressional hearings. See *United States v. General Electric Company,* Civil Action 2590, District of New Jersey; testimony of Thurman W. Arnold, Assistant Attorney

characterized by considerable expenditures upon legal departments designed to maintain and extend the patent structure and upon litigation wherever patents are infringed or challenged. For the greater security of the monopoly, a system of alliances is usually worked out with important patent-holding enterprises in related industries in order to make sure that competition shall not be encountered when any of these concerns acquires an invention that might be useful outside its own field. To this end such alliances usually provide for division of industrial fields and for interchange of any patent rights owned by either concern which the other can use.[63]

Often it is not expedient to exclude all competitors from a field that could be monopolized through patents. A concern that chooses to occupy an industry alone invites maximum efforts by others to develop alternative processes which might break its patent monopoly. It also invites legal challenge of its patent position. Where patent control is less than complete, the would-be monopolist is likely to have difficulty in acquiring the right to use patents held by others. For such reasons, it is frequently safer and more profitable for those who hold patents to grant licenses to other members of the same industry, as well as to allies in other industries.

In a patent-licensing system, the patent holder may obtain two types of benefits. On the one hand, he derives a revenue from royalties for the use of his patent. On the other, he limits the activities of his competitors by conditions attached to the patent license.

Competition is seriously restricted under patent-licensing systems.[64] The patentee often fixes the prices of products that are produced under

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General, before Senate Committee on Patents, *Hearings*, Part I, pp. 634-639, and testimony of John W. Walker, attorney, Antitrust Division, Department of Justice, *ibid.*, Part 9, pp. 4753-4800, and exhibits. Corning Glass Works accepted a consent decree in this case.

General Electric Company has denied the charge, and in support of its denial points to findings of the judge in a private suit as to the rate at which General Electric's fluorescent lamp was introduced and its sales enlarged. See *General Electric v. Hygrade Sylvania*, 61 F. Supp. 476, 481.

[63] See the agreements between Imperial Chemical Industries, Limited, and E. I. Du Pont de Nemours & Company, Inc., Senate Committee on Patents, *Hearings*, Part 2, p. 783. See also Corwin D. Edwards, *Economic and Political Aspects of International Cartels*, pp. 3*ff.* and *passim.*

[64] The ensuing discussion describes patent-licensing practices without purporting to distinguish between those that are legal and those that are not. The limits of legality in restrictive use of patent licenses are not yet clearly determined.

the patent.[65] In some cases he also attempts to fix resale prices to be charged by distributors who do not themselves make use of the invention.[66] He sometimes limits the quantity to be produced by each of his licensees.[67] He is likely to specify that the patent may only be used to produce certain types of commodities, or commodities to be sold in certain markets or through certain distributors.[68] Thus through the patent he may allocate markets, restrict output, and fix prices.

The effectiveness of such restrictions is increased by several characteristics of patent-licensing control. First, restrictions are customarily

[65] According to a government complaint, the U.S. Gypsum Company, following a meeting in May, 1929, of almost all the companies in the United States producing gypsum board, licensed each company to use certain of its patents for the production of gypsum board. In the patent-license agreements, the U.S. Gypsum Company reserved the right to fix the minimum prices at which the licencees might sell the patented board. Following the signing of the agreements, the company circulated a price bulletin stabilizing and fixing the prices for gypsum board for all the industry except one manufacturer and subsequently issued other price bulletins. See *United States v. United States Gypsum Company et al.*, complaint under the Sherman Act, Aug. 15, 1940, District of Columbia. While this book was in press, the Supreme Court reversed a lower court order which had dismissed the government's complaint and sent the case back to the lower court for completion of the trial. See 333 U.S. 364.

[66] The Univis Lens Company and its subsidiary, the Univis Corporation, were enjoined in 1942 from enforcing the provisions of any existing or future patent-licensing or other agreement which fixed the prices or terms for resale of lens blanks or lenses. See *United States v. Univis Lens Company, Inc.*, 316 U.S. 241. The companies had, through patent licenses and other agreements, designated the wholesalers and retailers who could handle Univis bifocal lenses, had sold only to those designated, and had fixed minimum resale prices. See also *United States v. Bausch and Lomb Optical Company*, 321 U.S. 707.

[67] Westinghouse was licensed by General Electric Company in 1912 to make and sell tungsten-filament lamps under General Electric patents up to 15 per cent of the aggregate net sales of such lamps in the United States by General Electric and Westinghouse. The royalty upon this production was 2 per cent (later changed to 1 per cent). Any excess production by the licensee was to be subject to a 10 per cent royalty. Quotas were also assigned to other licensees. Subsequently the Westinghouse quota was enlarged to 25½ per cent, and the punitive royalty for excess production to 30 per cent. Quotas of other licensees were also enlarged. See *United States v. General Electric Company et al.*, Brief for General Electric Company and International General Electric Company, Dec. 2, 1946, pp. 40-48.

[68] For example, the Du Pont Company and Rohm and Haas of Philadelphia arranged in 1936 that Du Pont would remain out of the production of laminated glass. Du Pont received no license under any patent claim to this product in the course of an agreement for mutual grant of royalty-free licenses under certain patents. See testimony of Walter R. Hutchinson, *op. cit.*, p. 688.

applied to any product that is produced under a patent. In consequence, if a patent covers any characteristic of the product or any part of the process of manufacture, this fact becomes a basis for restriction, even though all other parts of the product and process are unpatented.[69] Second, the license may be in effect perpetual, since it may be repeatedly enlarged to cover new patents and thus may be kept alive after all the original patents have expired.[70] Third, acceptance of the validity of the patent is likely to be one of the conditions of the license, so that in exercising control the patentee also makes his control less vulnerable.[71] Fourth, the licensee is often required to grant reciprocal licenses under his own patents and to convey to the patentee any improvements which he may make in the licensed products or processes.[72] Thus the licensing system may be used to increase the tech-

[69] In a complaint under the Sherman Act, the government alleged that the American Optical Company and others, as the owners of various patents, combined to fix prices for manufacturers, wholesalers, and retailers. According to the government's assertion, the so-called "Ful-Vue" patents claimed the idea of placing the endpiece of the frame at a specified point above the normal line of vision; restrictions were patented which claimed the idea of a brow arm running behind the lens and parallel to the top edge, without touching the lens; under the color of these patents the minimum resale price for the total frame and certain "extras" and for assembling lenses in such frames was set by the company. *United States v. American Optical Company,* complaint, Sept. 16, 1940, Southern District of New York. Trial of this case was postponed because of the war.

[70] Between 1926 and 1929 United States Gypsum Company licensed other manufacturers of gypsum plaster lath and wallboard under patents that covered the closing of the edge of the product so that it would not crumble. Some of these patents expired in 1929. Patent control was extended by license contracts which covered not only the rest of the closed-edge patents, but also patents on heat insulation and the use of starch in the plaster, and prospective patents on the use of bubbles in the plaster mix. The bubble patents were eventually granted in 1935 and 1937, so that their inclusion in the 1929 licenses had the effect of extending these until 1954, twenty-five years after the expiration of the first patents under which control was established. See *United States v. U.S. Gypsum Company et al.,* complaint filed Aug. 15, 1940, District of Columbia, pp. 34-84; Opinion on Motions to Strike Certain Exhibits and Testimony Received Subject to Connection and to Dismiss the Government's Complaint with Prejudice under Rule 41 (b) of the Federal Rules of Civil Procedure, by Judge Stephens, June 15, 1946, opening section.

[71] For example, U.S. Gypsum Company licenses for wallboard, footnote 57, pp. 224-225.

[72] The license-agreement form used by Universal Oil Products Company regarding the catalytic cracking process included the following provision: "The improvements and developments relating to the process licensed hereunder made or acquired on or before Dec. 31, 1947, by Licensee shall be available to Licensor." See Senate Committee on Patents, *Hearings,* Committee Exhibit No. 140, Part 8, p. 4418.

nological advantage of the patentee and to consolidate his patent position. Fifth, the licensee may be required to submit reports and to permit inspection of his books as a check upon the payment of royalties, and through these reports the patentee may obtain intimate information about the position of his competitors.[73] Sixth, the licensee is sometimes forbidden to use processes, materials, and patent rights obtained from third parties, and thus he may be placed in a position of commercial and technological vassalage to one particular patentee.[74] Seventh, by refusing licenses to some enterprises and discriminating in the terms of licenses issued to others, the patentee may control access to the industry and determine the relative chances of success among the concerns that are admitted.[75]

Even the royalty provisions of patent licenses may be used for restrictive purposes. One possible requirement is that the licensee shall pay royalties upon his entire output, including portions of it that are

[73] The Universal Oil Products Company's license-agreement form also provides "Licensee will keep detailed and accurate records of the character and amount of charge and products, operating conditions, and catalysts used, and will keep such detailed records and books of account as shall be necessary for the determination of royalties payable hereunder, and will furnish copies thereof to Licensor at Licensor's request. . . . Licensor may at any time, during business hours, make such examinations as it may deem necessary to verify such records and books of account." (*Ibid.*, p. 4418.)

[74] In 1928, the U.S. Circuit Court of Appeals, 3d Circuit, held that a patent licensing agreement between Radio Corporation of America, licensor, and DeForest Radio Company, licensee, violated Section 3 of the Clayton Act by requiring that the licensee should not use nor deal in vacuum tubes made or sold by a competitor of the licensor. The vacuum tubes were an essential part of the electrical circuits licensed for manufacture and the agreement required that the licensee purchase from the Radio Corporation "the number, and only the number of vacuum tubes to be used as parts of the circuits licensed hereunder and required to make initially operative the apparatus licensed under this agreement." *Radio Corporation of America v. Lord et al.*, 28 F. (2d) 257.

[75] In 1924 the Hartford-Empire Company and the Owens-Illinois Glass Company made the following agreement, allegedly in order to eliminate competition in the field of glass-making machinery: Owens gave Hartford an exclusive license under all its feeding and forming patents and withdrew from these products; Hartford gave Owens a nonexclusive license to make and use machines on Hartford's feeding and forming patents for manufacturing glass containers; Owens further had the right to use certain of these patents royalty free up to $440,000 and to receive one-half of Hartford's total income from licensed inventions over $600,000. This arrangement gave Owens a competitive advantage of about 14 per cent of its net income in 1928, 13 per cent in 1929, 24 per cent in 1930, 22 per cent in 1931, and 44 per cent in 1932. See House of Representatives Committee on Small Business, *op. cit.*, p. 224.

not produced under the patent. Such provisions discourage use of rival patents owned by other concerns or of alternative unpatented processes. In some cases royalties are used as devices to fix prices or to limit output. If, for example, the royalty is set high enough, it will be difficult for any licensee to inaugurate price competition against the patentee because of the importance of royalties in the licensee's total cost, and the potential revenue from the royalty may be so generous that the patentee does not care who makes the sale.[76] If the royalty rate is graduated according to the amount produced, the licensee may be deprived of incentive to enlarge his output except at relatively high prices, or he may be limited to a quota of production beyond which the rate of royalty is prohibitive.[77]

The restrictions upon competition that are brought about through patent-licensing systems fall into two broad classes. In one, patent control is divided among two or more members of an industry, each of

[76] In discussing royalties to be charged Sylvania Industrial Corporation upon moistureproof cellophane, a Du Pont official wrote: ". . . the larger the royalty per pound that he pays us the less difference it makes to us whether we supply the trade or whether he supplies it. I am citing some figures below by way of explaining this point, though the figures which I use are not accurate but merely used by way of illustration.

"Let us assume that the cellophane business is going to gradually increase and to an extent that additional plants will have to be installed from time to time to supply the growing market. Let us assume further that the investment required per pound of output per year is 70¢, and that over a period of years we should expect to make 15% return on our investment, which would be the equivalent of a profit of 10.5¢ per pound. If we assume that money is worth 8% then the cost of money required for this investment would be 8% of 70¢ or 5.6 cents per pound. On this basis the profit to us, over and above the cost of money, would be about 5¢ per pound and if, therefore, the royalty should be fixed at 5¢ per pound we would not suffer materially, if Sylvania's quota were somewhat increased over the original figure of 10%." See Edwards, *Economic and Political Aspects of International Cartels*, pp. 26-27.

[77] Under a 1938 agreement affecting the pour-point depressant business of Standard Oil of Indiana, Standard Oil Development Company, Monsanto Chemical Company, and Socony-Vacuum, the Development Company received complete control of this field. It granted Socony and Monsanto a nonexclusive license to make pour-point depressants, but under its terms the latter's sales were limited to 20 per cent of the aggregate amount of pour-point depressants sold under Development's patents by all parties in one year. Monsanto and Socony agreed to pay Development royalties of 3 per cent of gross receipts from sales under Development's patents and 30 per cent of the net sales over the 20 per cent quota. This high royalty rate of 30 per cent effectively stopped Monsanto from making sales over its quota. See Senate Committee on Patents, *Hearings*, Part 4, pp. 1764-1765.

which has a strong patent position. These concerns cross-license each other and mutually license other members of the industry. To control competition under such circumstances, the dominant concerns must agree among themselves about licensing policy. Restrictions applied by each to the other are essentially matters of agreement, in spite of their form as exercises of monopoly rights under patents.[78] Restrictions applied by the dominant concerns to their other licensees express a consolidation of the coercive control which the various patents have given to members of the dominant group. Because of this consolidation, the control is stronger than any of the patent holders could exercise separately. It often amounts to a kind of group monopoly, and joint action by the group to withhold patents is likely to be a sentence of business death.

In the second type of case a single concern enjoys a predominant position and imposes its control upon the rest of the industry through the restrictions incorporated in its licenses.[79] This is merely a special form of monopolistic control. In many of these cases a few unimportant patents are held by other members of the industry and are cross-licensed to the dominant concern; but the owners of these scattered patents dare not impose unwelcome licensing restrictions lest the preponderant group of patents be used to chastise them.

In some industries patent arrangements take a hybrid form. The patents owned by different concerns are pooled under a single control which is jointly responsible to the various owners.[80] Since the owners all receive licenses and all have a voice in the determination of policy, the situation resembles one of simple cross-licensing. Since, however,

[78] See the 1929 agreement between Du Pont Company and Imperial Chemical Industries, Senate Committee on Patents, *Hearings,* Part 5, Pack Exhibit No. 79-A, pp. 2392-2406; "The Duperial Companies, Argentine and Brazil," *ibid.,* Pack Exhibit No. 80, pp. 2406-2409; and "Description of I.C.I.'s Joint Interests with Du Pont in South America and in Canada," *ibid.,* Pack Exhibit No. 80-A, pp. 2409-2411.

[79] For example, General Electric Company in the production and sale of incandescent electric lamps, lamp parts, and lamp machinery. See *United States v. General Electric Company et al.,* Brief for the United States, Aug. 30, 1946, Civil Action 1364, District of New Jersey.

[80] For example, the oil patent pool known as International Hydro Patents Company, organized as a Liechtenstein corporation with exclusive right to license the hydrogenation patents of Standard Oil of New Jersey and Shell Oil Company. See Senate Committee on Patents, *Hearings,* Gibson Exhibit No. 37, "Outline of Proposal for Standard-Shell Agreement on Hydrogenation—April 15, 1930," Part 7, pp. 3664-3669.

the authority exercised by the different owners may be unequal and the policy followed has the coherence and continuity that comes from unified management, such a pool acts in some respects like a single dominant concern. From the point of view of licensees who are not members of the pool, this resemblance is particularly strong.

Where one concern has authority, patent restrictions are likely to work to the advantage of the patent monopolist and to be, in part at least, unwelcome limitations upon the licensees. This is also true of pooled patents in relation to nonmembers of the pool. As among members of the pool and as among participants in a cross-licensing arrangement, however, the distinction between patent holder and licensee is unimportant, since the various concerns act together to determine policy.

It is noteworthy that in some cases a concern or a group that exercises patent control follows a policy of accepting and protecting the established position of other concerns. In such cases the latter, too, are likely to find the patent restrictions congenial. Sometimes they are eager to be restricted.

Even patentees who are not members of the industry and who are interested only in maximizing their revenue from royalties are likely to include restrictive provisions in their patent licenses. What the patentee has to sell is not only the right to use an invention but also the right to exercise monopoly power. He may derive a greater revenue if he sells the second as well as the first. Consequently, he usually finds it profitable to assign exclusive fields to his various licensees or to give them licenses under which prices are controlled and production is limited.[81]

In granting exclusive rights to inventions and thereby preventing others from using those inventions without the consent of the patent holder, the government not only creates monopolies of particular bits of technology but also makes it possible for large enterprises to mo-

[81] The Wisconsin Alumni Research Foundation divided fields, fixed prices, controlled container sizes, and limited the potency of vitamin products. The license agreements created exclusive noncompetitive territories which eliminated competition between the different groups of licensees, and divisions were made as to the product to be activated with Vitamin D, the method of activation, and the use of the activated product. Minimum prices were fixed for the sale of licensed products. See *Wisconsin Alumni Research Foundation v. Rene Douglas,* Northern District of Illinois, Eastern Division, No. 43-C-704, Jan. 14, 1946 (reported in CCH, *Trade Regulation Reports,* 1944-1947 Court Decisions, Sec. 37,433). The government entered the case as counterclaimant against the Foundation.

nopolize industries as well as inventions, to allocate markets and industrial fields among themselves, to allocate products and markets among their licensees, to exercise a veto over participation in an industry by outsiders, and to restrict competition within an industry by provisions attached to patent licenses. Although these powers are theoretically limited in time, actually they sometimes have no ascertainable time limit and sometimes so consolidate monopoly power during the patent period that this power is perpetuated by other devices long after the patents have expired.

Moreover, because patent monopolies are governmentally sanctioned, use of the forms of patent control is particularly attractive to any group that desires to restrict competition. Cases are on record in which patents known to be invalid have been generally recognized and used within an industry because they were convenient instruments with which to conceal collusion.[82] In some instances the patentee has been a dummy agent of the licensees, his function being to place in effect their decisions about prices and production and to give them whatever legal protection might be afforded by patent licenses.[83] Thus the legality of various patent restrictions places a premium upon devices to evade the rule of competition by abuse of patent rights.

[82] The government alleged, for example, in its suit against the Hartford-Empire Company that, after the consummation of the 1924 agreement with Owens-Illinois Glass Company, the companies conferred to decide what should be done about various pending litigations and decided in one case to file a consent decree acknowledging that the patents in question were valid, and in another to drop an appeal, in order to avoid adverse court rulings regarding the validity of patent claims which might jeopardize their plans for domination of the industry. See *United States v. Hartford-Empire Company et al.*, Brief for the United States, Apr. 4, 1942, pp. 129-132. The defendants were held by the court to have violated the Sherman Act and Section 3 of the Clayton Act (46 F. Supp. 541).

[83] Compare *Wisconsin Alumni Research Foundation et al. v. United States.* See footnote 81, p. 234. See also testimony of Wendell Berge, Special Assistant to the Attorney General, before the Senate Subcommittee on War Mobilization of the Committee on Military Affairs, Washington, Oct. 21, 1943, Department of Justice press release of same date (mimeo.). In regard to monopolistic control over Vitamin D products, Berge stated that the Wisconsin Alumni Research Foundation was the vehicle for a domestic monopoly which resulted in division of fields, price fixing, control of container size, and limitation of potency of vitamin products. The details were determined jointly by the licensees. "The Foundation offered little more than a façade of respectability to conceal these activities, and it was for this concealment that the licensees were willing to pay so handsomely." (Pp. 17-18.)

THE PATENT LAWS: REMEDIES FOR ABUSES OF THE PATENT SYSTEM

A competitive policy calls for measures to prevent the use of patents as devices by which whole industries may be controlled. This requires substantial modification of patent law and procedure and substantial restrictions upon and safeguards around the monopoly rights conveyed by patents. The amount of change which is desirable must be determined not only by considerations of competitive policy but also by decision as to the incentives that are appropriate to the conduct, disclosure, and use of research. If patent monopolies are not needed as incentives, abolition of the patent system is the easiest way to meet the competitive problem. Examination of the nature of industrial incentives and of the means to promote technological development lies outside the scope of this book. For present purposes it will be assumed that patent laws are desirable aids to technological progress. Hence the changes here proposed in the patent system will be the minimum which appear to be necessary if that system is to be kept consistent with a competitive policy. They are not intended to exhaust the possibilities of patent reform.

The first important purpose of patent reform should be to prevent improvident patent grants. If public policy continues to approve the grant of monopoly rights as a reward for invention, care should be taken not to relax the standard of invention, not to make grants that are broader than the invention actually made, and to require that the invention be adequately disclosed. Since the patent law is now intended to impose such limitations, procedural rather than substantive change would be needed to make them effective. The aim would be to subject claims by applicants to more adequate tests in order that decisions by the patent office might be more satisfactory.

If this is to be the program, a variety of expedients may contribute to it. The personnel of the patent office should be increased in number and should be well enough compensated to attract and hold persons of high quality. Patent applications should be made public, and opportunity should be provided for submission of information and argument adverse to the grant.[84] Enough time and trouble should be

[84] A summary of national patent laws in effect before the war indicates that patent applications were required to be published in more than sixty jurisdictions, in some countries accompanied by summary specifications, and interested parties had from 1 to 3 months in which to oppose the grant. In Guernsey, opposition could be filed

taken to permit the patent office to consult technicians familiar with the particular industry and to assemble information sufficient to determine whether an alleged invention is adequately described and whether it actually makes a significant technical advance. This will necessarily mean more expense to applicants and to the government in the process of issuing a patent, but it may forestall subsequent costs of litigation over dubious claims. It need not mean more delay than at present provided patent office personnel is sufficiently increased, since the average pendency of an application is now about three years, even though the average time spent upon it by a patent examiner is only a few hours.[85] Most important of all, economic as well as technological tests should be applied in determining whether to grant the patent; that is, the patent office should consider whether or not the proposed grant would impede the progress of the useful arts, in the industries to which the invention is applicable, by unduly concentrating the control of technology. Such a test might be relevant to a decision whether or not the patent should be issued but would usually be applied only in determining the appropriate scope of the grant.[86]

It is probably desirable to make a more fundamental change in the basis for the patent grant. The major part of technological progress today is the result of systematic cooperative research in which each

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at any time before the patent was issued. In the Soviet Union, an inventor's certificate could be protested not only before but also for 3 years after its issue and a patent at any time during its life. Among the governments that provided an opportunity for opposition proceedings were Great Britain, Germany, the Soviet Union, Czechoslovakia, Japan, Netherlands, New Zealand, Norway, South Africa, and Sweden. See Corwin D. Edwards, *Varieties of Patent Legislation*, pp. 13-14.

[85] See testimony of I. Joseph Farley, *op. cit.*, p. 267.

[86] In a recent court decision it has been held that a proper reading of the patent law now imposes upon the patent office a duty to make these economic determinations. In *Monsanto Chemical Company v. Conway P. Coe, Commissioner of Patents*, No. 8472, Circuit Court of Appeals, District of Columbia, June 26, 1944, Associate Justice Arnold said: "There is only one possible way to determine the proper scope of protection for a single discovery. That is to examine the actual degree of control which the inventor hopes to gain by means of all his claims taken as a whole, over competing industry and competing invention. It is the duty of the Patent Office and of the courts to see to it that the reward is not in fact so large as to violate the Constitutional mandate by discouraging invention by others and thereby impeding the progress of science and the useful arts." In practice, however, the patent office accepts no such responsibility, and since it is not yet certain that Judge Arnold's views will be accepted by other courts and thus incorporated in the law, a clarifying amendment is in order.

worker builds upon the activities of his fellows. The results of this type of research do not spring from flashes of genius and cannot conveniently be attributed to particular individuals or, sometimes, even to particular research organizations. Thus the old standard of invention is becoming inappropriate. Moreover, in so far as the flash of genius still continues to provide new technological methods, it probably does not often need to be rewarded by a monopoly. On the other hand, systematic research is expensive, and there probably is need to maintain property rights in the results of research as an incentive to incur research expenditures. If such a standard were adopted, it might lead to a grant of control over new technological devices upon proof that systematic and expensive research activity had taken place rather than upon proof of the novelty of the invention. If such a standard were used, it would have the additional merit of tending to reduce the present sharp legal distinction between inventive activity, which gives rise to property rights, and the developmental activity of pilot plants, which, though essential and costly, is allowed to remain legally unrecognized.

Should research expenditures become the basis for grants of patents, the scope of the technology that is patentable might be increased rather than reduced, particularly in the case of research by large and well-equipped corporations. Such a result would be disastrous if the rights conveyed by patents were allowed to remain as broad as they are now. However, the recommendations set forth below are designed to make an industrial system permeated by patent rights more hospitable to the policy of competition.

A second major purpose of patent reform should be to prevent patentees from unreasonably keeping their inventions out of use. Since the grant of a patent constitutes governmental sanction for some degree of monopolistic action, the rule of reason appropriate in testing patent restrictions must be different from that applied to ordinary competitive markets. The most obvious standard in formulating such a rule of reason is the constitutional purpose to promote the progress of the arts. It is clearly inconsistent with this purpose for a patentee to keep his invention unused during the period of the patent grant. Patent laws in various foreign countries seek to enforce the use of patents by provisions invalidating patents that are not worked.[87] In

[87] See Corwin D. Edwards, *Varieties of Patent Legislation*, pp. 21-24. Belgium, Costa Rica, Cuba, France, Guatemala, Portugal, Rumania, Salvador, Soviet Union

practice, such provisions are clumsy; for in many cases an invention is incapable of commercial use until improvements in process and reductions in cost have been devised, and there is no convenient way by which a patent office can determine whether the time is ripe for commercial exploitation. Other patent laws, however, contain a provision that offers a way out of this difficulty. They require a patentee who is not working his invention to grant licenses to applicants who may wish to do so.[88] Thus the test of the commercial practicability of a patent becomes simply the willingness of a commercial enterprise to use it. The patentee is allowed to retain his monopoly rights during the portion of the patent period in which the invention is being developed to the point of usefulness, however long that portion may be, but he is not free to keep the invention out of use thereafter if someone else is willing to use it. A compulsory licensing provision of this kind should be incorporated in the patent law of the United States.

This law should be so drawn as to bring about use of a patent in all fields where its use is practicable. If the patent owner is not able to work his patent in particular industrial fields or to use it to supply particular geographical territories, he should not be permitted to keep it out of use there. Rather he should be required to license it for such uses.

To make such licensing requirements effective a supplement is needed. A patent holder may try to retain his patent monopoly by production of merely nominal quantities under the patent or by sale at prices so high as to be well-nigh prohibitive. If the principle of monopoly as a reward for invention is to be retained, it will not be practicable to require the monopolist to produce as much and sell as cheaply as though he were a competitor. Nevertheless, there is need for some remedy in cases in which the monopolistic policy is so restrictive as to afford only nominal use of the invention. In theory, it would

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Turkey, Uruguay, Venezuela, and various other jurisdictions had absolute requirements in prewar patent legislation that the patents must be worked within specified periods of time. Some form of excuse by the patent owner could be accepted for failure to work the patent in Australia, Austria, Canada, Czechoslovakia, Finland, Great Britain, Eire, Italy, Japan, Netherlands, New Zealand, Peru, Spain, Sweden, and some other countries.

[88] In Cuba, Iraq, Spain, and Syria, revocation of the patent could be avoided by offering the patent for license. In Bolivia, Greece, Iraq, and Nicaragua, offer of the patent for license was regarded either as the equivalent of working or as sufficient evidence that there was reasonable excuse for failure to work. (*Ibid.*, pp. 21, 23.)

be possible to cope with such problems by public regulation of the amounts to be produced and the prices to be charged, but any government might reasonably refuse to undertake such a vast amount of regulation of market transactions. The patent laws of various countries contain a second and more promising method of attack: in granting a patent a government may retain the right, in case of abuse, to require the patentee to extend licenses to all applicants.[89] This reserved power is a deterrent for any concern that may be tempted to adopt a highly restrictive policy, and it also provides a remedy where the temptation is not overcome.[90] An analogous provision should be included in American patent law. The abuse which is to be thus prevented might be defined as such a limitation of supply or such a level of price as to prevent a reasonable use of the invention,[91] and the costs

[89] Compulsory licensing as a remedial measure against abuse of patents occurred before the last war in some form in more than sixty patent laws, including those of the following countries: Australia, Austria, Canada, Czechoslovakia, Denmark, Eire, Germany, Great Britain, Japan, Mexico, Netherlands, New Zealand, Norway, Poland, South Africa, Soviet Union, Spain, Sweden, and Switzerland. (*Ibid.*, p. 20.)

[90] In England the power has been seldom invoked, although its existence has apparently strengthened the bargaining position of applicants for licenses. There is apparently no agitation in England to abandon this type of compulsory licensing as unduly severe. Instead, some critics of the law contend that more ambitious remedies are needed. See *The Patents System: Patents and Licenses of Right,* published by Botts Pure Drug Co., Ltd., dated Jan. 31, 1944; *Patents and Licenses of Right,* published by Imperial Chemical Industries, Ltd., dated Oct. 8, 1943; *Patents and Designs Acts,* Second Interim Report of the Departmental Committee, Board of Trade, London, April, 1946, especially pp. 7-9.

[91] The Patents and Designs Act of Great Britain, as amended, provides that compulsory licenses may be issued if there has been an abuse of monopoly rights under the patent. Patents are deemed to have been abused

"(a) If the patented invention (being one capable of being worked in the United Kingdom) is not being worked within the United Kingdom on a commercial scale, and no satisfactory reason can be given for such non-working; . . .

"(b) If the working of the invention within the United Kingdom on a commercial scale is being prevented or hindered by the importation from abroad of the patented article by the patentee or persons claiming under him, or by persons directly or indirectly purchasing from him, or by other persons against whom the patentee is not taking or has not taken any proceedings for infringement;

"(c) If the demand for the patented article in the United Kingdom is not being met to an adequate extent and on reasonable terms;

"(d) If, by reason of the refusal of the patentee to grant a licence or licences upon reasonable terms, the trade or industry of the United Kingdom or the trade of any person or class of persons trading in the United Kingdom, or the establishment

and profits of the patent holder might be regarded as relevant but not sole factors in determining the extent of reasonable use.[92]

Another unreasonable prevention of use is a licensing policy that blocks the development and use of patents held by others. One danger inherent in a patent system is stalemate due to the fact that several

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of any new trade or industry in the United Kingdom, is prejudiced, and it is in the public interest that a licence or licences should be granted;

"(e) If any trade or industry in the United Kingdom, or any person or class of persons engaged therein, is unfairly prejudiced by the conditions attached by the patentee, whether before or after the passing of this Act, to the purchase, hire, licence or use of the patented article, or to the using or working of the patented process;

"(f) If it is shown that the existence of the patent, being a patent for an invention relating to a process involving the use of materials not protected by the patent or for an invention relating to a substance produced by such a process has been utilised by the patentee so as unfairly to prejudice in the United Kingdom the manufacture, use or sale of any such materials. . . ."

See *Patents and Designs Acts,* p. 8.

[92] The Patents and Designs Act (1907) of Great Britain, with amendments as of July 13, 1939, provides as follows:

"Part I. Section 24(b). In settling the terms of any such [general] license the comptroller shall be guided by the following considerations—

"(i) he shall, on the one hand, endeavour to secure the widest possible user [*sic*] of the invention in the United Kingdom consistent with the patentee deriving a reasonable advantage from his patent rights;

"(ii) he shall, on the other hand, endeavour to secure to the patentee the maximum advantage consistent with the invention being worked by the licensee at a reasonable profit in the United Kingdom;

"(iii) he shall also endeavour to secure equality of advantage among the several licensees, and for this purpose may, on due cause being shown, reduce the royalties or other payments accruing to the patentee under any license previously granted:

"Provided that, in considering the question of equality of advantage, the comptroller shall take into account any work done or outlay incurred by any previous licensee with a view to testing the commercial value of the invention or to securing the working thereof on a commercial scale in the United Kingdom."

In the case of exclusive licenses, the Act provides: "Part I. Section 27. (4). In settling the terms of any such exclusive license . . . due regard shall be had to the risks undertaken by the licensee in providing the capital and working the invention, but, subject thereto, the license shall be so framed as—

"(a) to secure to the patentee the maximum royalty compatible with the licensee working the invention within the United Kingdom on a commercial scale and at a reasonable profit;

"(b) to guarantee to the patentee a minimum yearly sum by way of royalty, if and so far as it is reasonable so to do, having regard to the capital requisite for the proper working of the invention and all the circumstances of the case."

different patentees, who have obtained monopolistic rights over different portions of a productive process, have been unable to agree to pool these rights, and thus are severally prevented from using the process as a whole. The patent laws of various countries attack this problem by authorizing any patentee to obtain a license under a patent held by another if he can show that his own patent cannot be worked without this license and if he is willing to grant a reciprocal license.[93] This provision should be incorporated in American patent law.

Such a provision would also tend to prevent abuse of the rule, proposed above, that an unused invention be subjected to compulsory licensing. Without a requirement for reciprocal licensing of complementary patents, it would be possible for the owner of a basic patent to withhold licenses under it, thus preventing owners of patents on improvements from using their patents; and then to obtain compulsory licenses under these improvement patents because of nonuse. With reciprocal licenses provided for, such tactics could not be adopted, for the owners of the improvement patents would be able to obtain licenses under the basic patent if they were willing to grant reciprocal licenses upon their improvements.

A third major purpose of patent reform should be to prevent the development and perpetuation of great concentrations of patents which give enduring monopolistic power over a whole industry. One means of reducing such power would be to reduce the rights conveyed by patents. Under a general system of compulsory licensing,[94] for example, the enterprise with many patents would obtain a large revenue from

[93] Before the recent war the Bahamas, Barbados, Bermuda, Bulgaria, Czechoslovakia, Grenada, Greece, Iceland, Leeward Islands, Norway, Northern Rhodesia, Southern Rhodesia, St. Lucia, St. Vincent, Seychelles, Swaziland, Switzerland, and Trinidad provided for compulsory licensing under a patent when the license was necessary to enable the owner of another patent to make the best use of his invention. In Bulgaria, Czechoslovakia, Greece, Iceland, and Norway, however, such licenses were made available only if the blocked invention was of considerable public importance, and in Switzerland, if it was a distinct technical improvement. Bulgaria, Greece, and Iceland required the recipient of such a license to grant reciprocal rights to use his own patent. See Corwin D. Edwards, *Varieties of Patent Legislation,* pp. 19-20, 24.

[94] In Danzig and Luxembourg, before the war, licensing might be required for any patent without proof of specific abuse, if the government believed the public interest was served thereby; in Guernsey, the court's power to issue licenses was not limited to specific abuse. (*Ibid.,* p. 24.)

royalties, and to that extent would be strengthened. But it would no longer have the power to exclude others from an industry by withholding its technology. Hence it would lose much of its power to impose restrictions as a condition of access. We have already seen that compulsory licensing is a remedy for various other patent abuses. Its relative simplicity and effectiveness makes it the most attractive single measure of patent reform in dealing with the problem of concentrated power as well as with other problems.

However, since the purpose of this chapter is to propose minimum changes in the patent laws, other measures, more complex and less effective but more modest, must also be considered. The most useful of these would be action to remove the exclusive features from patent pools wherever the patents thus pooled are numerous enough and important enough to be a source of substantial power. The destruction of the power of such a pool can seldom be accomplished by a mere program of dissolution which returns the various groups of patents to their former owners, for enterprises that have come to rely upon the pool of patents cannot continue to use satisfactory technological methods unless they retain licenses from other members of the pool. Though this necessity could be met by granting all members of the pool nonexclusive licenses under the patents formerly pooled, there would be danger that the pool would be tacitly perpetuated by a general unwillingness of the former members to grant additional licenses under the patents. Hence it would ordinarily be necessary to require that the pooled patents be made available for license to all applicants on nondiscriminatory and nonrestrictive terms. Such a remedial program could be adopted for pools whether or not compulsory licensing and the prohibition of restrictive clauses in licenses were made general.

To cope with an array of patents held by a single producing enterprise is more difficult. In principle, it might conceivably be decided that a concern may not hold patents governing more than one method of accomplishing a technological result. The patent office would then be required to deny patent applications assigned to an enterprise if other patents governing alternative processes had already been so assigned and had not been disposed of. In addition, the fact that the patentee possessed patents governing alternative processes might be used as a defense in infringement suits.

There are many objections to such a remedy. In some cases a single patent might govern more than one technological alternative. In

other cases it might be difficult or impossible to determine in advance to what extent various patents represented alternative techniques. To make such a rule effective the corporate fiction would have to be pierced so effectively that large enterprises could not evade the requirement by assigning different groups of patents to different subsidiaries or affiliates. Acquisitions of alternative technology by license as well as by assignment would have to be prevented. Moreover, even if the rule could be adequately enforced it would leave untouched the power that comes by combining patents that cover many successive steps of a process and many different characteristics of a product. Hence this type of attack is no satisfactory substitute for compulsory licensing.

If a program more modest than general compulsory licensing is wanted for such cases, it can be found only in a decision to differentiate between the requirements applied to small groups of patents and those applied to great aggregations of patents. It might be possible to differentiate between the monopolistic power over a piece of technology that is conveyed by a patent and the monopolistic power over a whole industry that may be obtained by assembling patents; to prohibit the latter; and to attack it case by case by requiring divestitures of patents or compulsory licensing suited to each particular set of circumstances.[95] To preserve the productive activity of the large concern, it would usually be necessary to permit the enterprise to retain a nonexclusive license under any patents thus divested.

A fourth major purpose of patent reform is to prevent impairment of competition within an industry through monopolistic restrictions incorporated in patent licenses. The most direct and effective way to

[95] A similar distinction between broad and narrow patent control was invoked with reference to a single patent by Associate Justice Arnold in the case of *Monsanto Chemical Company v. Conway P. Coe, Commissioner of Patents,* No. 8472, Circuit Court of Appeals, District of Columbia, June 26, 1944: "If an inventor acquires a patent on a can opener the fact that others may not make this particular appliance will encourage the development of other types of can openers and stimulate invention. This furthers the Constitutional purpose of the patent grant. On the other hand, if the can opener patent goes beyond the particular appliance and includes the method or process of opening cans it may easily become so broad that others are prevented from making or inventing new can openers. This defeats the purpose of the Constitutional provision. To determine whether the allowance of any particular claim will have such a result requires an inquiry into the facts of the industrial situation: How much control does the inventor expect to get by virtue of the claim which has been refused? How will that control probably affect the activities of others in the field?" See also footnote 86, p. 237.

accomplish this result is to prohibit the patentee from including restrictive provisions in the license.[96] Under such a system licenses would become merely means to collect revenue from sale of rights to use an invention. They would cease to be means to control the marketing of a product.[97] Such a requirement would prevent patent-licensing systems from being used as cloaks for collusive activity and would substantially reduce the opportunity for the patent holder to acquire coercive power over other members of the industry.

Nevertheless, there are difficulties in adopting this remedy. In many cases the patent holder is incapable of exploiting his patent in all the industrial fields and in all the territorial markets where it might be useful. So long as he is free to impose restrictions upon the right to use the patent, he may retain his monopolistic advantage within his own field of activity while still permitting others to make use of the invention elsewhere; and a part of the present proposal is to require him to grant such permission. If he is prohibited from limiting the products the licensee shall make or the territories in which the licensee may sell, he will be forced either to keep the patent partly out of use or to run the risk of competition in his own markets. There is danger that under such circumstances patents will often go unlicensed so far as the law permits. Similarly, it is probable that within the patent holder's own industrial field he will be less willing to grant licenses to competitors if he is unable to control the amounts these competitors sell and the prices they charge.

[96] HR. 2612, 79th Congress, 1st Session, Mar. 14, 1945 (Bailey Bill), would have made it unlawful to include certain types of restrictive provisions in contracts involving the use of American patents if any party to the contract was a foreign person. This bill was aimed specifically against abuse of patents by cartel arrangements. The restrictive provisions banned were to be those acting or tending to fix prices, fix terms or conditions of sale, exclude anyone from a particular territorial market or field of business activity, limit supply of goods, exclude goods from commerce, fix production or sales quotas, monopolize commerce, or suppress technology or invention. See also HR. 97 introduced in the same session by Mr. Voorhis on Jan. 3, 1945, which, among other things, would have made illegal any license agreement restricting the price of any article sold or handled under the patent right.

[97] Because of the possibility that the royalty provisions of licenses might be used to accomplish restrictive results indirectly, such a principle would necessitate either requirements as to the character of royalties or reservation of the right to intervene where indirect restrictions actually appeared. If it were found practicable to require that royalty rates be nondiscriminatory and that royalties at rates increasing with additional product be avoided, most of the more obvious abuses of royalties could be forestalled.

If patent owners are to be required to grant general licenses to all comers, the problem discussed above ceases to be relevant. If, however, the patentee is to be permitted to enjoy exclusive rights to use his own invention, he must be permitted either to keep the invention out of use in fields of business activity that he does not occupy or to restrict his licensees in these fields sufficiently to prevent them from competing with him or to limit the effectiveness of this competition. The recommendation which has already been made that compulsory licensing be provided for all fields in which the owner of the patent does not operate implies a recommendation that the patent owner be permitted thus to restrict the licensees.

A restriction that goes no further than to exclude licensees from the particular field of activity occupied by the licensor or to limit their competition in that field need not cause great concern. True, in particular instances it may diminish the number of competitors in the patent owner's field, reduce the efficiency of competitors unable to obtain a license, or subject competitors to controls over production and prices. But these effects are likely to be partially offset by the fact that a policy of withholding licenses provides a greater incentive for competitors to search for alternative technologies.

But to accept this type of restriction does not require acceptance of other types of licensing restrictions. The patent owner need not be permitted, in fields where he does not operate, to guarantee his licensees exclusive occupancy of their various markets or to fix their prices and restrict the volume of their production or to give some of them discriminatory advantages over others. Licenses should be available to all applicants on terms that are nonexclusive, nondiscriminatory, and without other restrictions than those that reserve rights to monopolize or restrict use of the patent in the patentee's own field. Though the patentee may retain his right to complete or partial monopoly, he should be deprived of his status as an organizer of monopolies among licensees and as vendor of monopoly rights to licensees.

A more complete application of this same principle would suggest that the right to reserve any market or field of use should be granted only to the original inventor or, if the inventor is an individual not engaged in business, to his original assignee, but that no business enterprise should be allowed to convey exclusive rights in certain parts of the market to another business enterprise by assignment of the patent.

One more important difficulty remains to be dealt with. It springs not only from the prohibition of restrictive provisions in licenses but

also from the various proposals for compulsory licensing. It consists in the danger that expensive developmental activity may not be undertaken if there is insufficient chance to recover the outlay from subsequent monopoly profits. The danger can exist only in cases in which the prospective royalties from compulsory licensing are inadequate to justify the necessary expenditures. Its extent is uncertain. It has been exaggerated by some opponents of patent reform to such an extent as to imply the question why any outlays to develop products and markets are ever made where there is no patent protection.[98] However, with a heavy discount for overemphasis, there is still need for care lest expenditures for development be unduly curtailed.

The problem arises in a relatively small portion of the patent field. Some patents do not require development and others can be developed cheaply. Some compulsory licenses will provide large royalties. Where ownership of patents is diffused, the danger that other concerns will get a head start may be a sufficient incentive without further inducement. If special protection is needed at all, the need is proportional to the probable cost of development rather than to the profit-yielding possibilities of the patent or the size of the concern that holds it. It would be improvident to relax the protection of important public interests in the case of all patents in order to meet a problem presented by a few patents. The proper remedy is the use of special measures to encourage development at any particular points where such measures are needed.

These measures might take several forms. Subsidies might be granted to help cover development expenses, either directly or by appropriate reductions in taxes. Where development expenses are

[98] See testimony of Philo T. Farnsworth, vice-president, Farnsworth Television, Inc., before TNEC, *Hearings,* Part 3, p. 995. "Why, without the patent situation I don't see any hope of starting any such an enterprise. Certainly no one can be expected to subscribe such a large amount of money without having it protected; without having a basic reason for so doing and without the money, without this order of money, no such development—well, there is no point in ever starting any development of that magnitude." See also testimony of Maurice H. Graham, independent inventor, Minneapolis, Minnesota, *ibid.,* p. 1075. "I don't think in the electrical appliance field that I have ever built an item that I could go out to somebody and get him to build it if he only had the use of it for a year or two or three. . . . If I would go to them, for instance the General Electric Co., and ask them to spend $50,000 to advertise this [coffeepot], then in a given time anybody could come in, I don't think I would ever be able to sell it. I couldn't interest them in it."

heavy, the duration of the patent might be extended.[99] Rights to reserve markets and fields of use occupied by the developing concern might be granted in these cases, even if not generally. Through measures such as these it should be possible to provide incentives for development without tolerating serious impairment of market competition. If all else should fail, the government might even undertake to bear the cost of expensive development programs for promising inventions under an arrangement by which the governmental outlay would be repaid only from subsequent royalties and profits upon products resulting from the invention. Dubious as such a program may be, it probably would cost the public much less than is now exacted by the exercise of unduly restrictive patent rights.

[99] In Australia, for example, a patent's duration is fixed by a court, within specified legal limits, as may be appropriate to permit the patentee to make a reasonable profit from his invention. See Corwin D. Edwards, *Varieties of Patent Legislation*, pp. 16-17.

VII. RELATION OF THE COMPETITIVE POLICY TO REGULATION

PREVIOUS CHAPTERS have discussed the program to be followed in order to prevent anticompetitive private forces from destroying competition or seriously reducing its effectiveness in those areas in which it is the basis of public policy. This chapter will discuss the relation between the field of competitive policy and other fields in which a policy of competition has been replaced by one of public control.

Programs of public control fall into two broad classes: those that are applied to particular segments of the national economy in order to improve the performance of these segments, and those that are intended to maintain balance, coordination, and a high level of activity in the economy as a whole. In the first group fall such programs as the regulation of public utilities and of new security issues. In the second fall programs to eliminate depressions and to assure full employment.

THE SCOPE OF SEGMENTAL CONTROLS

Segments of the economy selected for special governmental regulation may be either industries or types of transaction. The public controls applied to them are of many varieties. They include, for example, government ownership and operation of business undertakings, such as the work of the Tennessee Valley Authority (TVA); government subsidies of private ventures that conform to specified standards, such as the Federal soil-conservation programs; government guarantees that private losses will be repaid if specified types of activity are undertaken, such as the loan guarantees of the Federal Housing Administration (FHA); government review and amendment of private business decisions, such as the authority which the Interstate Commerce Commission (ICC) exercises over railroad rates; government licensing of private business ventures, such as the control exercised over radiobroadcasting by the Federal Communications Commission (FCC) and that over civil aviation by the Civil Aeronautics Board (CAB); and di-

rect governmental fixation or limitation of the prices to be charged by private business ventures, such as the price ceilings of the Office of Price Administration (OPA). The limited scope of this book prevents any effort to discuss the many detailed questions that arise about the bearing of the competitive policy upon the variant devices used to regulate particular segments of the economy. Attention will be given only to certain broad problems that arise in many different varieties of segmental public control.

Furthermore, no effort will be made here to evaluate the wisdom of particular decisions to rely upon control rather than competition in specified segments of the economy; for maintenance of vigorous competition within the competitive area does not depend upon the precise location of the boundary line between competition and control, and appraisal, case by case, of the relative claims of competition and control is a task too large to be undertaken parenthetically in a work upon another subject. That there will be significant amounts of public control in a modern economic system is inevitable. That public control should be undertaken only where a wise man would prefer it to competition is desirable, but not indispensable to the success of the competitive policy. Some mistakes can be tolerated. The problem of this chapter is how to prevent developments within the controlled area of the economy that are disastrous for effective competition within the competitive area.

But although the exact boundary line between competition and control is unimportant, the relative scope of these two policies is necessarily of concern in maintaining the vitality of competition. It would be possible to destroy the competitive policy by progressively enlarging the area of public control until little of importance was entrusted to competition. Shaving by shaving, the stick could be whittled entirely away.

Whether or not the controlled areas are large, competition should be the rule and control the exception. This principle is inherent in the nature of these alternative techniques for safeguarding the public interest. The legal and the administrative content of competition do not differ from case to case. New public decisions about goals and methods are not required for each industry or activity to which competition is applied. To broaden the field of competition is not to increase appreciably the amount of governmental resources which must be used to maintain competition. A competitive program does not necessarily become weaker as it becomes wider. By contrast, policies

of positive control require varied and responsible action by the state at every point where these policies are to take effect. Every new controlled area exacts a new consideration of goals and methods and an additional use of the government's resources. It is difficult to imagine a wise use of segmental public control not based upon analysis of a particular problem and formulation of the reasons for public action, whereas little is demanded of the government in the way of information, analysis, or purpose in order to maintain at some particular point those safeguards of the public interest that inhere in a system of private checks and balances. Where the government is uninformed or uncertain and where the goals of public action are not clear, competition is feasible, but control would be unfortunate.

Moreover, as the field of direct governmental control becomes wider, there is an increasing danger that government will become the agent of controlled groups and cease to speak consistently for the general public. In a democratically organized society, the right to influence the government is enjoyed by those who are members of a controlled group as well as by those who lie outside it. As the number of controlled groups increases, their aggregate influence upon government is increased likewise. They are under incentive to make loose alliances among themselves for the purpose of mitigating the severity of controls or reshaping control programs in their own interest. The resistance to such alliances grows smaller with each extension of the areas of control. Hence unusual circumstances are required to maintain the integrity of a broad system of repressive regulation. A democratic government can fix the price of taxicab services or exercise a veto upon transportation rates, for many persons use such services and the control is imposed upon few; but even in such cases, there is some difficulty because the pressure upon government by those who are controlled is intense and persistent, whereas that by the general public is diffused and intermittent. Similar control of prices covering the whole economy is not feasible except when controlled groups are unusually acquiescent, as in time of war. When ordinary commercial motives come into play, alliances of producers against price control become so powerful that government has only two alternatives: either to relax the controls until they are ineffective or to see them abolished. Recent experience with the OPA furnishes an example of this play of forces.

Since the government lacks the capacity to assume an indefinite variety of responsibilities, economy of effort requires a limitation of

the field of segmental control. Each specific control should be instituted because in the particular case competition would not accomplish one or more important public purposes which the control can achieve. If no such case can be made, competition should prevail.[1]

This means that wherever there must be a choice between policies of competition and segmental control, the burden of proof should fall upon those who advocate control. The presumption should be in favor of competition. Decisions to extend the area of control should be made in awareness that there is a limit to the aggregate amount of control which the government can undertake and that for this reason the use of control must be economized. If this principle is invoked in an economy such as ours, competition will be more prevalent than segmental control, and will, therefore, be the most significant force in determining the character of business relationships.

DANGER THAT SEGMENTAL CONTROLS MAY BE PERVERTED

One of the chief dangers in the application of public segmental controls is that competition will be set aside improvidently under pressure from monopolistic groups. In a democratic society private interests are free to organize for political action, and business interests usually organize themselves along industrial lines. Government is under steady pressure from trade associations, large and small, for action designed to further their several interests.[2] With the growth of great business combinations, giant enterprises, too, have acquired political influence as single entities and are assiduous in using it. Previous chapters have described certain successful efforts by politically power-

[1] This formulation is intended for use in a system that accepts in general the institutions of private property and private business enterprise. Much of it is applicable, however, even in a collectivist society. To believe that the effects of private business are generally bad is not to escape the burden of affirmatively planning the public conduct of business. With faith in the capacity of government to manage industry and distribute goods, one may vastly expand the field of public action and correspondingly reduce the field of uncontrolled private action. Even so, however, some economic decisions will be private, those that are private should be competitive, and the field of competition should be that in which no clearly defined public purpose can be served by specifically designated instruments.

[2] See TNEC Monograph No. 26, *Economic Power and Political Pressure.* See also listing of lobby registrations for fourth quarter, 1946, under Public Law 601, 79th Congress, Tit. III, *Congressional Record,* Vol. 93, No. 23 (Feb. 5, 1947), pp. 863-884. See also Cecil Holland, Series on Lobby Activities, *Chicago Sun,* June 1-3, 1947.

ful business groups to obtain rights of private collusion by exemption from the antitrust laws and to establish legal barriers against free entry into business and free access to markets by their less powerful competitors, particularly competitors from abroad. Before the great depression of the 1930's, these were the conventional limits of organized business effort to pervert the competitive policy. Recently, however, another type of perversion has been widely advocated and sometimes achieved: use of the machinery of the state to formulate and execute direct programs of price fixing and restriction of output.

This development has been incident to a progressive breakdown of the distinction between public and private persons and interests. In the United States this type of thinking first became politically influential in the efforts of farmers' organizations to persuade the Federal government to maintain prices for farm products.[3] Governmental control of domestic agricultural markets was said to be an equivalent for the protection of manufacturers by tariffs. At first adopted sparingly, restrictive control of farm products was made general after 1933 through the Agricultural Adjustment Administration (AAA).[4] At the

[3] See Chester C. Davis, "The Development of Agricultural Policy Since the End of the World War," *Yearbook of Agriculture,* 1940, pp. 297-316.

[4] Appeals for controls and laws designed to enhance farm income found increasing favor in the 1920's. Cooperative marketing was approved under the Capper-Volstead Act and further implemented by the Cooperative Marketing Act of 1926. Surplus removal was an intended goal of the various so-called "McNary-Haugen" bills. In 1927, the Business Men's Commission on Agriculture, under the sponsorship of the Chamber of Commerce of the United States, advocated a program of planned land use and soil conservation as one device to support farm prices, and recommended that the government promote cooperative marketing of farm produce. (See Business Men's Commission on Agriculture, *The Condition of Agriculture in the United States and Measures for Its Improvement,* National Industrial Conference Board and Chamber of Commerce of the United States, Washington, D.C., 1927.) In 1929 the Agricultural Marketing Act was enacted. The act embodied a policy to promote effective marketing and equalize the position of agriculture and other industries. This was to be accomplished by "aiding in the preventing and controlling surpluses in any agricultural commodity through orderly production and distribution. . . ."

In the Agricultural Adjustment Act of May 12, 1933, restrictionist controls over production and marketing were vastly expanded. Section 2 of the act expressed a policy to maintain a balance between production and consumption of farm products. To this end acreage controls were introduced for the basic national crops and for livestock, and mandatory marketing agreement provisions were promulgated (Part II, Tit. I). Upon the invalidation of the processing tax provisions of the law, the program was carried forward through enactment of the Soil Conservation and Domestic Allotment Act (Act of Feb. 29, 1936, 49 Stat. 1148), and the Agricultural Ad-

same time, under the stimulus of a severe depression, similar programs for businessmen were developed on a large scale through NRA. NRA Codes were formulated upon the theory that the broad public interest would be served by a systematic enlargement of the earnings of producing groups in each industry, even though the devices used were largely restrictive measures designed to transfer income to that industry from the rest of the community.[5] In the code-making process, business groups were given authority to draft for executive approval codes of business conduct which were to have the force of law; the government denied itself the right to add to these codes provisions that had been neither suggested nor accepted by these business groups;[6]

justment Act of 1938 (Public Law 430, 75th Congress, 3d Session). Title III of the latter act provides for marketing and parity payments designed to enhance farm income. The purposes of the act, in general, are soil conservation and the "balancing" of production with demand. Provision is made for acreage allotments, under certain conditions, to attain this end.

The Agricultural Marketing Agreements Act of 1937 (Public Law 137, 75th Congress) amended the marketing provisions of the AAA, solidifying the purposes and reiterating the marketing policy. Under the stress of wartime need the farm program was redirected to stimulate farm production. See *Annual Report* of the Secretary of Agriculture, 1941, pp. 79-80. The Steagall Amendment (Public Law 147, 77th Congress) directed the Secretary of Agriculture to support the prices of nonbasic agricultural commodities when he deemed expanded production necessary. With the war over, the Department of Agriculture has again begun to think about devices designed to maintain farm income. See *Annual Report* of the Secretary of Agriculture, 1945, pp. 29-30, 36-38.

5 See *The ABC of the NRA*, Brookings Institution, Washington, D.C., 1934, pp. 29-30. See also statement of Donald R. Richberg, executive director, National Emergency Council, *Hearings* before Senate Finance Committee, pursuant to S. Res. 79, 74th Congress, 1st Session, Investigation of the National Recovery Administration, pp. 5-7.

6 In June, 1933, the Special Industrial Recovery Board, created in the recovery program under Executive Order 6173, issued NRA *Bulletin* No. 2, which in part stated: "It is not the function of the National Recovery Administration to prescribe what shall be in the codes to be submitted by associations or groups. The initiative in all such matters is expected to come from within the industry itself. . . ." In NRA Press Release No. 7 the assistant administrator was quoted to the same effect (June 22, 1933). While NRA did prepare a so-called "model code," which was altered and modified from time to time, its provisions were general, and its purpose was to serve as a guide. The preface of the Model Code of Nov. 6, 1933, stated that with the exception of those provisions required by the National Industrial Recovery Act itself all other provisions were optional. Utilization of the model code provisions varied from division to division in NRA, and many provisions in approved codes varied considerably from the model. See Harry Mulkey, NRA Work Materials No.

and the administration of the codes was entrusted to businessmen who were privately designated and who were not required to surrender their private interest in the results of their own administrative decisions.[7] The ideological origins of this system of so-called "self-government of industry" were various: the monopolistic aspirations of business groups, the opinions of trade associations about business ethics and industrial organization, the political philosophies of syndicalism, of Italian Fascism, and of German National Socialism, mercantilistic economics, and a theory of a guaranteed minimum profit akin to labor's concept of a minimum wage. As fused in the NRA program, these ideas were fundamentally inconsistent with democratic political organization and with a competitive economic policy.

After NRA, some American observers perceived the possibility that business executives might exercise governmental power without surrendering their private interests and purposes and that restrictive programs expressing particular business interests might be restated as government programs.[8] This possibility was potentially attractive to certain business organizations which, though subject to the limitations of the antitrust laws in their private acts, would enjoy unusually great opportunities for influence over such a governmental system. The plausibility of such a use of government was strengthened by the fact that restrictive controls over agriculture in the interests of farm producers continued to be central in American agricultural policy.

Within five years after the collapse of NRA, the Second World War provided a new laboratory for experiment with the techniques of

36, *The So-called Model Code, Its Development and Modification,* particularly pp. 91-93. While Sections 3(d) and 4(b) of the NIRA provided for codes prescribed by the government and for licensing powers, they were never invoked. See *Report of the President's Committee of Industrial Analysis,* 75th Congress, 1st Session, House Document No. 158, p. 10.

[7] The President's Committee of Industrial Analysis (referred to above) reported: "Many of the problems and difficulties encountered in the administration of codes by code authorities arose from the anomalous character of their functions. Their members were competitors of their constituents and of each other. Accepted as the representatives and spokesmen of their respective industries, yet clothed with responsibilities as quasi public officials, they were subjected to the irreconcilable influences of their own personal interests, their loyalty to their constituencies, and their allegiance to their public trust." The committee concluded that the delegation of authority to code authorities was "excessive and ill-defined." (P. 80.)

[8] *Cf.* James Burnham, *The Managerial Revolution,* The John Day Company, New York, 1941, particularly pp. 139-153.

merging public and private action. A governmentally directed war economy was managed in large part by business executives drawn into government service. In some war agencies, these executives were permitted to make decisions about their own industries and interests.[9] In the most important war agencies, administrators were surrounded by advisory groups representing producers in particular industries and were expected, so far as possible, to develop public policies after prior consultation with such groups.[10] Since ordinary commercial motives were usually subordinated to the central purpose of winning the war, both by the business executives drawn into government and by those whom they governed, this system was much more successful than its predecessor in NRA. But it has left a residue of businessmen who look complacently upon the extension of government control and presume that such control can be made to operate for business purposes and under business direction. Suggestions have been made for indefinite continuance of international governmental boards to allocate raw

[9] Executives of the War Production Board were drawn primarily from business, and often made decisions affecting their own companies. Even in the Office of Price Administration, where, in an effort to select impartial administrators, professional economists were given an exceptional amount of executive authority, it was sometimes found necessary to appoint section and division chiefs and trade specialists who handled problems arising in industries whence they had come. Thus a director of the Consumer Goods Price Division was a former sales manager of a textile manufacturing corporation, and a director of the Food Price Division had been with and later returned to a cereal manufacturing corporation. The same situation prevailed at the regional and district levels. In one regional office the chief of the Coal Section had operated coal-producing property and his assistant had worked for a large retail coal establishment. Similar conditions prevailed for building materials and construction as well as for other consumer goods.

[10] Under Section 2(a) of the Emergency Price Control Act of 1942, as amended [56 Stat. 23 (Jan. 30, 1942)], the price administrator was required to advise and consult with representative members of an industry and to give consideration to their recommendations before issuing any general price regulation or order for the industry. In addition, the administrator was required, on requests from any substantial portion of the industry after a maximum price or maximum prices had been established, to form an industry advisory committee, either national or regional or both. Thereafter the administrator was to consult with such committees at their request, concerning price orders, regulations, classifications, and adjustments. The Stabilization Extension Act of 1944 made OPA's obligation to consider such recommendations explicit. The Price Control Extension Act of 1946 required the administrator, upon request, to appoint regional industry advisory committees. The act also provided that private decontrol petitions could originate only with industry advisory committees, and that the advisory committees had the right of appeal to the Decontrol Board upon denial by OPA of such petitions (Sec. 1A).

materials; for government stock-piling of large quantities of basic minerals, accompanied by manipulation of purchases for commercial ends;[11] for international commodity agreements to control the marketing of primary commodities that are in surplus supply;[12] and for surveillance by the State Department over the content of international business agreements.[13] These proposals have not come from groups adversely affected by the business interests that would be subjected to the proposed controls. Proposals about primary products have come from farm groups which desire to make international the domestic governmental restrictions upon farm products.[14] Among the foremost advocates of other proposals have been businessmen who would be subject to the restrictions and certain business executives who were responsible for similar programs during the war.

Thus the developing pressures of self-interest from syndical organizations of business, strengthened by the emergency measures incidental to a great depression and a great war, have tended to break down the idea that market activity should be competitive and that government policy should be developed only for public ends and through public instruments. They have popularized a philosophy under which public regulatory powers would be put at the disposal of private groups for private ends.

An important requisite of the competitive policy is to resist this type of effort to enlarge the sphere of government control of marketing. To this end it is necessary to do battle for political principles which

11 See, for example, statement of Julian D. Conover, secretary, American Mining Congress, in *Hearings* before the Subcommittee on Surplus Property of the Senate Military Affairs Committee, on S. 752, S. 1481, and S. 1522 (stock-piling), 79th Congress, 1st Session, Oct. 30, 1945, pp. 65-75. See also statement of J. Carson Adkerson, president, American Manganese Producers Association, *ibid.*, p. 76.

12 In March, 1947, representatives of twenty-three nations, including the United States, Canada, and England, met in an International Wheat Conference in London and expressed general agreement on the desirability of an international wheat agreement. The program is directed to the setting of world minimum and maximum prices, control of national stock piles, and coordination of national production programs. See *The New York Times*, Mar. 22, 1947, p. 8. See also Joseph Davis, *International Commodity Agreements: Hope, Illusion, or Menace?*, published by the Committee on International Economic Policy, 1947.

13 See "Resolution on International Business Agreements," adopted by the Board of Directors of the National Foreign Trade Council, Jan. 26, 1945. See also address before the Trade and Commerce Bar Association, New York City, Jan. 4, 1945, by Creswell M. Micou of Curtis, Mallet-Prevost, Colt, and Mosle.

14 See Davis, *op. cit.*, p. 81.

were once thought to be platitudes: that restrictive regulation of any particular group should originate in a desire by the community to make that group serve the public interest, not in the group's desire to use the power of the community to serve that group's own interest at the expense of others; that to enable particular groups of sellers to make profits or to avoid losses is not a part of the public interest; and that policies which are designed to increase profits by restrictive means are objectionable whether they are publicly or privately established. Avoidance of types of public control that violate these principles is an important part of the competitive policy.

If these principles were to be accepted, they would require not only precautions against future public controls of the NRA type but also elimination of such controls where they have become established. This means repeal of legislation that authorizes the Secretary of Agriculture to impose marketing orders designed to maintain agricultural prices or to allocate shares in agricultural markets.[15] It means, too, that the agencies which now exercise quasi-governmental power over agricultural marketing agreements should be deprived of their public status and that the agreements themselves should not be enforceable except through the ordinary law of contract.[16] It means that wartime public agencies set up to allocate scarce commodities and to keep prices down, should not, when the scarcities disappear, be perpetuated as agencies to dispose of surplus production on terms satisfactory to the producers. It means that American participation in international commodity agreements, such as that for wheat, should be withdrawn. It means that the government should cease to subsidize primary commodities, from cotton to silver, where the subsidy is intended merely to enlarge the incomes of the producers or to give one producing group an advantage over another.

Failure to extirpate all such perversions of public power will not, of course, wreck the competitive policy. Here, as elsewhere, shortcomings of performance and occasional compromises with groups that are politically and economically powerful can be tolerated in practice, objectionable though they may be. However, it is imperative that such acts be generally regarded as improper and that governments

[15] Act of May 12, 1933, 48 Stat. 31, 73d Congress, 1st Session, as amended and reenacted by Act of June 3, 1937, 50 Stat. 246, 75th Congress, 1st Session.

[16] Thus made wholly private, such agreements would be illegal combinations in restraint of trade except for specific exemptions given them by the agricultural laws. Chapter III has suggested that these exemptions be withdrawn.

which undertake them and groups which advocate them be placed on the defensive. The danger in recent years has been that the rescue of private-interest groups may come to be accepted as a proper function of government and that programs designed for this purpose may become general rather than exceptional. The competitive policy could not survive such a development.

PRECAUTIONS NEEDED IN SEGMENTAL CONTROL: CLEAR BOUNDARIES

Assuming, however, that segmental control is undertaken for purposes that are not flatly inconsistent with the existence of competition, there remain several substantial problems as to the relation between competitive and controlled areas. The first of these is maintenance of a satisfactory boundary for the policy of competition. If competition is abandoned more widely than control is applied, there will be a no man's land of business activity in which the public interest is safeguarded by neither competition nor control. If control is unduly sweeping or gives some special advantage to an enterprise subject to it, it may render competition ineffective in the supposedly competitive area. If the points for control are unwisely selected, a control that appears to be adequate may fail in practice, and bastard forms of competition may arise which there was no intention to encourage and which serve no public purpose. Avoidance of such dangers requires a careful dovetailing of the policies of competition and control.

The difficulties that arise when the boundaries of control are not appropriately defined have appeared clearly in recent years in railway-rate regulation. The theory of this regulation has been that individual carriers may initiate rate changes subject to protest by shippers or competitors, and that the ICC may review proposed rates either in response to such protests or upon its own motion. Because of the vast amount of detail involved in rate changes, the commission examines not more than 1 or 2 per cent of the rates that are filed with it. Thus private decisions remain in large part unreviewed. Restrictive combinations among the carriers are subject to the antitrust laws in so far as they have not been specifically sanctioned in the Interstate Commerce Acts. In practice, however, carriers have organized rate bureaus which receive and review proposed rate changes before these are submitted to the ICC. The practical effect of the activities of such bureaus appears to be that many changes in rates and services which are

desired by a particular carrier are never filed with the ICC because of objections by competing carriers. The Department of Justice has charged that the activities of these rate bureaus violate the antitrust laws.[17] In defense of the rate bureaus it is argued that they perform an indispensable function because conferences between roads representing alternate routes are indispensable to the coordination of short-haul rates with through rates and to the formulation of rates between points that can be reached only through the services of more than one carrier. This need is regarded as so important that various members of the ICC have, from time to time, given tacit or explicit endorsement to the rate-bureau system. Thus it appears that the antitrust laws may forbid certain desirable forms of common action by carriers and that there is a gap in the regulatory devices available to prevent rate bureaus from taking action contrary to the public interest.

To avoid no man's lands, care must be taken to maintain the rule of competition up to the point at which control begins. In general, American laws are successful in doing this; for the antitrust laws are general in their application, and the more specific laws that provide for control usually contain an express or implied exemption from the antitrust laws which is no wider than is required by the control programs. Since specific enactments take precedence over general laws with which they are inconsistent, a neat joint between the exception and the rule is made wherever the control law does not explicitly provide for exception from the antitrust laws, or does so too narrowly. However, as is shown by the case of railway-rate bureaus, a neat legal joint does not necessarily establish the boundary line of public control in the most appropriate place. Moreover, some badly drafted control laws contain exemptions that are unduly broad. Mention has already been made (see Chap. I) of the exemption by which the Shipping Act of 1916 permits shipowners to agree upon the level of rates, yet grants the Maritime Commission inadequate authority to review rate questions.

To eliminate the no man's lands of control requires some modifica-

[17] See, for example, *United States v. Association of American Railroads et al.*, complaint, Aug. 23, 1944, District of Nebraska. While this book was in press, the Congress passed, over the President's veto, a bill to exempt rate bureaus from the antitrust laws. Opponents of the measure argued that it was weakly safeguarded. See *Congressional Record*, June 16, 1948, pp. 8588-8610; June 17, 1948, pp. 8711-8712, A4219-A4222.

tion of statutes and a substantial increase of administrative resources at certain points where the statutes are inadequate.

The opposite fault—extension of control into the supposedly competitive area—seldom appears unless businessmen desire it; for the controlled group is likely to protest any extension of control which it finds inconvenient. Sometimes, however, those who are controlled welcome a lessening of competition not inherent in the public purposes of the control, and therefore gladly propose or accept devices that have such an effect. An illustration of an unduly sweeping control is the price-filing system which was included in the NRA Code for the tag manufacturing industry. Under this system sellers were required to sell at prices and upon terms which they had filed in advance with the code authority, but were supposedly to determine their respective prices and terms in competition with one another.[18] The code provided that in selling any product for which the seller had not made a complete filing, he was to be presumed to have filed the lowest price and most favorable terms filed by a competitor. Under this rule, which appeared to do no more than provide for oversights and omissions, all members of the industry except one large concern refrained from filing anything; and that large concern's prices thus became mandatory and uniform minima for everyone.

In some cases control in one area reduces the effectiveness of competition in another area, not because the control is unduly extensive, but because status as a controlled concern gives a competitive advantage. This tends to be true wherever the controlled enterprise enjoys a legal monopoly in the controlled field and is also allowed to engage directly or indirectly in uncontrolled activities. Monopolies of telephone service are appropriate and can be adequately controlled at the service level. However, where the monopolistic service companies are large or are permitted to combine into large units, the monopoly power of these companies extends over the supposedly competitive manufacture of telephone equipment. Controlling the demand for such equipment, the service company is in a position to dominate competing suppliers. If the service company chooses to establish a manufacturing subsidiary, it may concentrate the manufacturing business in its own company to the exclusion of independent manufacturers. In so far as the service company obtains patents, these patents give not only the right to use the invention but also the right to make

[18] See *Codes of Fair Competition*, Vol. VI, pp. 53*ff.*, approved Feb. 1, 1934.

and sell it. Thus patent control extends not only over service activities but also over the manufacture and sale of equipment incorporating the patented inventions.

The union of manufacturing and service activities in the same company can also be used to thwart the purposes of public control over the service activities themselves. It is customary to approve the establishment of communication rates at levels sufficient to cover costs plus a fair return upon the invested capital. Purchases from controlled manufacturing companies are elements of cost, and since the profits of these manufacturing concerns are not likely to be subject to control, there is a constant danger that costs in the controlled area will be padded by unduly high prices upon transactions between the manufacturing and service branches of the concern.

Problems of this kind should be met, wherever possible, by insistence that business units shall not lie across the boundaries of public control. The effectiveness of competition is so sharply reduced where a competitive enterprise is free to appear at will as a controlled enterprise that such forms of organizations should be avoided. Public utilities should be required to divest themselves of subsidiary operations that are not subject to control. This method of simplifying the problem can be used, of course, only where dissolution and divorcement would be consistent with the maintenance of healthily functioning enterprises. There may be cases in which a concern cannot be divided. In such instances, extension and coordination of control is the only possible solution. Programs of public control should give the controlling agency authority to regulate any activity of the controlled enterprise through which the purposes of the control may be defeated or in which an undue competitive advantage may be derived from the control, whether or not this activity falls directly within the controlled area.

Closely related to this problem is that of the special power which may be obtained by an enterprise large enough and diversified enough to operate throughout a commercial field that is subject to several uncoordinated agencies of control. Domestically, for example, a railroad controlling an airline would be subject to both the ICC and the CAB. Internationally, an air transport company is subject to the aviation authorities of several different countries. In such cases it is possible for the controlled company to provoke inconsistencies and conflicts in the regulations prescribed by the different authorities, to foster the

development of no man's lands where each authority waives jurisdiction on the theory that the other is exercising it, and thus to obtain a freedom of action greater than would be tolerated under any central system of control. So far as possible, the boundaries of the jurisdiction of regulatory agencies should be made to correspond with the boundaries of the companies which they control, either by extending the field of regulation or by limiting the scope of the business enterprises. However, to do this will be often difficult and sometimes impossible.[19]

PRECAUTIONS NEEDED IN SEGMENTAL CONTROLS: AVOIDANCE OF EXCESSIVE DETAIL

The experience of NRA with price filing and price fixing abounds in cases in which the points for control were unwisely selected and

[19] A striking illustration of the dangers inherent in jurisdictions that are narrower than the phenomena to be controlled appeared in the postwar development of international aviation. An American control policy designed to encourage low rates and the competitive establishment of rate levels encountered a British and Continental policy designed to maintain rates and allocate business among competitors. Since there is no international coordination of these policies, the intermediaries between the control agencies are the international airlines. Their proposals to set up air rates by private agreement were accepted not only by European governments, which sympathized with such schemes, but also by the American government, which is trationally opposed to any such action but cannot insist upon rates and procedures that other governments will not accept. For example, in Oct., 1945, Pan-American Airlines reduced the rate for the New York-London passage from $572 to $275. British officials criticized Pan-American for cutting rates without consultation with the International Air Transport Association (IATA). The association, with a membership representing fifty-seven international airlines, had established machinery for setting minimum charges just before the rate cut.

Before the first trip at the reduced rates, the British government informed "Pan-Am" that its flight schedule between the United States and England must be reduced from five to two trips per week. The company described the order as retaliatory and accused its competitor, American Airlines, of influencing the British government to this action. See "British Cut 'Pan-Am' to 2 Flights a Week," *The New York Times*, Dec. 1, 1945, pp. 1, 15. Later, delegates of the United Kingdom and the United States agreed at the Bermuda Air Conference (January-February, 1946) that rates to be charged by either British or American air carriers would be subject to the approval of the two governments within their constitutional rights to take such action. The CAB announced its intention to approve the rate-conference machinery of the IATA, as submitted, for a period of one year beginning in February, 1946, and subsequently extended this approval. For the machinery of the agreement, see "Bilateral Air Transport Agreement between the Government of the United States of America and the Government of the United Kingdom relating to Air Services between Their Respective Territories," Annex, par. I-II.

perverse forms of competition were consequently encouraged. Many such schemes were originally applied to list prices and the more important discounts and terms of sale. Frequently their effect was to induce sellers to offer buyers more generous treatment in portions of a transaction not specifically controlled. The result was that while the important elements of a transaction remained rigid, competition was keen in giving premiums and unnecessary services, accepting smaller orders, enlarging cash discounts, delaying the mailing of bills, and granting other heterogeneous concessions, most of which reduced the simplicity and economy of the marketing process. Drug wholesalers made deliveries to retailers in "one-twelfth dozen lots," and until stopped by an additional code provision, tobacco merchants gave customers several books of matches with each package of cigarettes.[20] Though competition persisted, much of its usefulness was destroyed.

The effectiveness of the competitive policy will be enhanced if the methods of control used in controlled areas are such as to leave the maximum possible scope for competition and to avoid such diversions of the incentive to compete. Broadly speaking, there are two types of control. One relies upon public determination of the terms of business transactions. It substitutes authority for competition first in the principal features of a sale and, later, in order to avoid evasion, in a progressively widening range of lesser details. It is inconsistent with the continuance of healthy competition at any point within that range. The other type of control does not attempt to determine directly the characteristics of each purchase or sale. It consists in making sweeping public decisions by which the environment for business transactions is controlled and continuous incentives are provided to act in one way rather than in another.

Price fixing constitutes a typical regulation of the first type. To make such a rule effective, control must be extended to cover all the terms of sale in which price concessions or premiums may be concealed, and these manifold rules must be made effective in the detail of every transaction. Except by the force of example, successful control of the price in one transaction does not guarantee success in the next instance. An effort to establish price levels by the second method of control might include such devices as government-purchasing programs through which the total demand for certain goods is increased,

[20] See H. F. Taggart, *Minimum Prices under the NRA*, Michigan Business Studies, Vol. VII, No. 3, University of Michigan Press, Ann Arbor, 1936, p. 330.

food-stamp plans through which purchases by certain classes of consumers are subsidized, taxation programs designed to absorb surplus money, and programs of public works designed to enhance pay rolls and total purchasing power. Through devices such as these, price-raising or price-lowering influences may be introduced into the market without effort to determine the exact points at which they shall become effective or the exact ways in which they shall operate. In this type of control the detail of business transactions is still determined by competition, and the effect of the control is merely to warp this competition toward a desired pattern. Obviously, the second procedure is more hospitable to competition than the first.

In making segmental controls consistent with a competitive policy, these distinctions should be given weight. Wherever possible, controls that require a few public decisions of broad scope should be preferred to those that require many public decisions of narrow scope. Wherever possible, controls that modify incentives should be preferred to those that prescribe acts. Such choices are desirable because they economize the work of applying the control, but they are also to be preferred because they preserve more of the flexibility and variety which are characteristic of the competitive process.

The alternatives may be illustrated from policies appropriate to the control of inflation. In an attempt to stabilize price levels, reliance may be placed primarily upon such influences as the supply of money and credit, levels of taxation and government expenditure, the balance of international payments, and incentives to bring about the production of more goods.[21] Alternatively, the principal instrument of control may be rationing and detailed regulation of prices and terms of sale. It is obvious that in so far as the purpose of the control can be served by measures of the first type rather than of the second, the field of competition will be widened. Even when fiscal measures prove insufficient, alternatives of emphasis are possible between price control on the one hand and limitation of demand through rationing on the other. A rationing program interferes less with the competitive process because in deciding the amounts that customers may buy it need not cover the many details about quality, terms of sale, channels

[21] Most controls exercised through money, credit, and tax policies are likely to be general rather than segmental. Efforts to strengthen the incentives to produce may be either general or segmental. Price control, on the contrary, is inherently the regulation of segments of the economy, even though practically all prices may be controlled.

of distribution, and price relationships which cannot be omitted in a program of price control.[22]

PRECAUTIONS NEEDED IN SEGMENTAL CONTROLS: COMPETITION BETWEEN CONTROLLED INDUSTRIES

Effective competition can also be promoted by policies designed to maintain the freedom to choose between one type of controlled enterprise and another. The protection afforded by competition does not consist merely in the ability to play one trader off against another within a single market. It consists also in the ability to turn to substitute goods and to satisfy one's needs from the products of different industries. Where a system of control has been established for the determination of such essentials as price and quality, the buyer is dependent upon the control rather than competition in a narrow range of decisions relevant to his choice between competing producers, but he may retain a competitive protection, even against an unsatisfactory system of control, in his freedom to prefer the products of other industries. This latter type of protection should not be improvidently destroyed.

This point may be illustrated by the control of different methods of transportation. A traveler may proceed within the country by bus, by rail, or by airplane, and overseas by airplane or by ship. Goods may be forwarded by truck, rail or water freight, rail express, or air express. The regulation of motor carriers has reduced the direct competition between one truck line and another; and the regulation of railways, that between one railroad and another. Shipping competition has been reduced or eliminated by private shipping conferences under very loose public control, and air competition is being subjected to varying degrees and types of control by the aviation authorities. In the process, the buyer's ability to protect himself by turning from one carrier to another has been and is being lessened. However, he retains the power to put pressure upon railroads for faster deliveries by turning to airplanes, and for lower rates by turning to trucks and

22 This comment should not be interpreted as an assertion that the problem of inflation during the Second World War and the ensuing reconversion period could have been dealt with by fiscal means alone or by fiscal measures supplemented by rationing. The replacement of competition by control under OPA was conspicuous, but the extent to which that replacement might have been avoided is a controversial matter which lies beyond the scope of the present discussion.

busses. Competitive pressures of this type may be of substantial importance as incentives. The policies of control agencies should be so designed as to retain these incentives.

Current systems of control within the United States reflect an awareness of this point. In the development of transportation lines, and particularly of aviation, care has been taken to limit the right of carriers operating one type of transportation service to engage also in competing types of service. CAB is unwilling to permit airlines to be controlled either by railroads or by shipping companies.[23] The control of motor carriers by railroads requires specific assent by the ICC, which, in general, has sought to restrict the railway companies to the provision of supplementary rather than competitive motor services.[24]

Nevertheless, there has been reiterated demand from transportation companies for rights to invade competing fields and for adoption of a theory of control based upon an effort to coordinate all types of transportation service.[25] Movement in this direction would substantially reduce the competitive protection which remains under public regulation and would correspondingly increase the burden of protecting the public which the control agencies must assume. The nature of the problem which would be thus created is evident where partial coordination has already been attempted. In exercising jurisdiction over both trucks and railroads, the ICC appears to have been influenced by a belief that the railway system is the country's basic means of transportation and that the well-being of railways should be maintained even by sacrifice of some of the interests of the motor carriers. Such tenderness for a substantial vested interest against interests that are smaller and newer is almost inevitable in a control that seeks to coordinate substitutionary types of service. It not only reduces the area of competition but tends to destroy the safeguards for progress which are inherent in a competitive policy.

[23] See Civil Aeronautics Act of 1938, Public No. 706, 52 Stat. 973, 75th Congress, 3d Session, Sec. 40 (a) (b). See also *Annual Report* of the Civil Aeronautics Board, 1942, p. 28, and "Sea-Air Plea," *Business Week*, Sept. 14, 1946, pp. 51-53.

[24] See Motor Carrier Act of 1935, Public No. 255, 49 Stat. 533, 74th Congress, 1st Session, Sec. 213.

[25] See, for example, *Summary* of Discussion by the Association of American Railroads in Regard to the National Transportation Inquiry (H. Res. 318, 79th Congress), par. I (4) (5), p. 7. See also statement of Donald C. Conn, executive vice-president of the Transportation Association of America, reported in *The New York Times*, July 28, 1945, and "Want Right to Run Air-Water-Rail-Truck Transportation Systems," *Wall Street Journal*, Sept. 11, 1943.

PRECAUTIONS NEEDED IN SEGMENTAL CONTROLS: SUBSTITUTES FOR COMPETITIVE SAFEGUARDS

Segmental systems of control should not only retain competition so far as possible but also have purposes consistent with those of the competitive policy. Not all aspects of the public interest are safeguarded by competition, but those that are so protected are important throughout the economy. They should not be neglected where the technical inadequacy of competitive devices or the importance of additional purposes has led to a policy of public control. Hence policies of control should include specific safeguards designed to provide the types of protection that are ordinarily afforded by competition.

The most important of these are protection against oppressive transactions, maintenance of opportunity for innovation, and provision of inducements to improve the efficiency and economy of business operations. Wherever a system of public control reduces or destroys the opportunity for those who trade with a controlled enterprise to turn from one alternative to another, it enhances the bargaining power of the controlled enterprise. Wherever control restricts the right to enter an industry, regulates the way in which production is to be carried on, or prescribes the character of the product, it diminishes the ordinary opportunities for innovation by newcomers and for change of methods by concerns already in the field. Wherever control protects established concerns against competition or stabilizes the income from business operations, it impairs the incentive to strive for maximum efficiency. The extent to which such ordinary competitive safeguards are reduced differs widely from instance to instance according to the nature and scope of the control. The impairment should be fully offset in each case by new protections, opportunities, and incentives incorporated in the control itself.

Existing programs of public control are often deficient when measured by this standard. Space will permit only a brief illustration of certain deficiencies.

In the regulation of public utilities, all three points are insufficiently provided for. Exploitation of the consumer is usually checked by direct control of the amount and quality of service and by rate regulation under which charges are publicly determined or subjected to public review. However, the standard in fixing rates—usually the provision of a fair return upon the fair value of the property—places reasonable profit in the foreground and subordinates such considerations

as increase in the amount of business done and provision of service at prices appropriate to the consumer's ability to pay. Price-reducing influences which jeopardize profits are set aside, and there is usually no incentive to seek more volume by methods that hazard present profits against the possibility of enhanced future gains. Consequently, the public-utility industries have often been slow to develop mass markets and to discover business opportunities at low prices. Only when exposed to the competition of TVA did the private electric-power companies of the Southeast discover that low rates would so increase volume as to increase profits.[26]

Incentive to use new methods has also been often lacking. In much of the public-utility field, newcomers are required to obtain franchises or certificates of convenience and necessity, and such rights to engage in business are granted sparingly. Although there are a few cases in which the motive for such exclusion appears to be mere protection of vested interests, technical considerations often require monopoly or a severe restriction of the number of concerns. With potential competition largely eliminated, progress depends upon innovations by companies already established. Yet under the philosophy of fair return upon fair value, there is little incentive for an established public-utility company to scrap its old equipment in order to improve its methods of operation. Rather, there is an incentive to keep equipment in use long after it is obsolete. No newcomer threatens to take the business, and all equipment used contributes to the value of property upon which a fair return will be earned. For example, a telephone executive informed the writer that his company introduced the French telephone at a rate designed to avoid scrapping any of the older type telephones until they were completely worn out.

Since public-utility companies are protected against competition and enjoy a right to a determined amount of profit, they often have no adequate incentive to reduce their operating costs; for falling costs may provide a basis for action by the regulatory authority to reduce rates. Indeed, there is some incentive to pad public-utility costs with high salaries, luxurious offices, and other expenditures that contribute to the immediate comfort of the operating staff. Moreover, there is an obvious incentive to increase expenditures upon cultivation of public

[26] See TNEC Monograph No. 32, *Economic Standards of Government Price Control*, pp. 51-52, 428-429. See also Merle Fainsod and Lincoln Gordon, *Government and the American Economy*, pp. 359-360, W. W. Norton & Company, New York, 1941.

good will, lobbying, conduct of legal proceedings, and any other devices that may help make regulatory standards more lenient.

These deficiencies in regulatory safeguards are deprived of some of their capacity to do harm by the fact that the process of regulation is often ineffective. Much of the ingenuity of public-utility companies has been devoted to devising legal and accounting techniques for padding the rate base. So successful have these devices been that it has often been possible, by manipulating the concept of fair return upon fair value, to retain extra profits if they could be earned.[27] Within the limits of this possibility, certain incentives to improve processes, cut costs, and expand markets have existed even though they were not provided by law.

But such incentives need not be derived from failures of regulation. In some systems of public-utility regulation, means have been found to encourage more vigorous managerial policies. Inducements to cut prices and enlarge markets have been provided by assurance that profits thus attained will not be wholly destroyed through regulation.[28] Incentives to improve processes and cut costs have been similarly strengthened.[29] The opportunity to make profits higher than a fair return has been substituted for the ordinary competitive incentive. TVA and the Rural Electrification Administration have made it clear that government competition can be used to strengthen private incentive.[30] It may be that still better methods can be found to accomplish these results.

However, so long as the principle of fair return upon fair value governs regulatory techniques, it will be difficult to provide incentives by

[27] See Irston Barnes, *The Economics of Public Utility Regulation,* pp. 561-562, Appleton-Century-Crofts, Inc., New York, 1942.

[28] *Ibid.,* pp. 350-354.

[29] Commission efforts to improve efficiency and stimulate utilities to reduce costs have included both positive and negative incentives. The Alabama commission has stated that its power in prescribing just and fair rates includes weighing the facts as to whether management is efficient and economical. Commissions have issued orders limiting rates of return to less than otherwise might be available because no real effort had been made to maintain adequate service. They have allowed higher than normal rates as rewards for high efficiency. These instances, however, have been sporadic and nontypical. See William E. Mosher and Finla G. Crawford, *Public Utility Regulation,* pp. 88-89, Harper & Brothers, 1933.

[30] In the *Annual Report* for 1940, the Secretary of Agriculture reported that the first five years of operation of the Rural Electrification Administration "had seen rural-electrification activity, by R.E.A. borrowers and by private utilities alike, at a speed unprecedented in the history of the U.S." (P. 137.)

direct regulation. What is needed is revision of the regulatory concept. The process of regulation is one that jeopardizes the interests of producer and consumer alike, and in which the danger of confiscation of the producer's property is accompanied by a danger that consumers' property rights and opportunities will be impaired by lethargic and inefficient production. Could such a concept be established in law, it might permit experiment with standards of regulation based, not merely upon fair return, but also upon fair growth of the industry and fair opportunities for the general public to enjoy the benefits of mass production under the best available methods.

PRECAUTIONS NEEDED IN SEGMENTAL CONTROLS: ROUGH EQUALITY BETWEEN CONTROLLED AND UNCONTROLLED INDUSTRIES

In addition to providing safeguards equivalent to those of competition, public segmental controls should be so administered as not to promote an unbalance in the allocation of resources. As Chap. I has already pointed out, competition cannot be relied upon to produce an equilibrium of economic forces or to guarantee a proper allocation of resources to needs. In these respects the alternative to control is not perfection. When controls are applied to particular parts of the economic system, there is no reason to expect the several programs to make any substantial contribution to the development of an economic balance. However, they should at least be so managed as not to worsen the balance appreciably.

For this reason prices and profits established under public control should be roughly comparable to those in uncontrolled areas. If controls are unduly generous to those controlled, diversion of resources into the controlled areas and reduction of the demand there are likely to contribute to an excess capacity which roughly measures the ineffectiveness of the control. If controls are unduly severe, new investment within the controlled field will be avoided. Technical progress will lag, quality of service will decline, and shortages will gradually develop. If controls are unduly rigid, price relationships between stable controlled prices and unstable free prices will be constantly disturbed, and enterprises, both regulated and unregulated, will suffer wider ranges of gain and loss than are necessary.[31] To prevent seg-

[31] The operating margins enjoyed by controlled enterprises will rise when free prices are low and fall when free prices are high. Conversely, the operating margins

mental control from becoming a force toward unbalance in the economy, prices and profits under competition should be accepted as a rough guide for results under control. So far as possible, average rates of profit for uncontrolled concerns which continue to exist and expand should be taken as a basis for fair return in so far as the fair-return concept remains influential in regulation, and uncontrolled price relationships and price movements should be taken as a basis for the adjustment of controlled prices.

The application of such a standard would be impossibly difficult if it were attempted by statistical analogy. Even without refined measurement, it can be applied only partially.

A rough competitive test can be applied to the profits of controlled companies. The markets for new securities are primarily influenced by profits and prospects of profits for the companies whose issues are bought and sold. In such markets the new security issues of utility and transportation companies compete against those of unregulated companies. The scale of profits in controlled companies should be regarded as too low when such companies have relative difficulty raising capital for expansion. It should be regarded as too high when they can raise money more easily and at lower rates than other types of business.

The problem of maintaining a rough equality between the prices of controlled and uncontrolled industries is primarily one of cyclical price change. Divergences among groups of prices over long periods are to be expected, and momentary fluctuations of price are impractical under price control. However, the rigidity of controlled prices is so great that during most of a depression transportation rates may remain at the high levels appropriate to the end of the previous boom, and during the early stages of a boom they may remain at the low levels appropriate to a depression. Moreover, in emphasizing the importance of a fair return, regulatory commissions sometimes cut rates in periods of rising prices because profits have been increased by an increasing volume of business and similarly raise rates during periods of falling prices in an effort to compensate a loss of profits due to a decline in volume of business.[32]

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enjoyed by unregulated enterprises will decline more sharply when free prices fall, and rise more sharply when free prices rise, than would be the case if controlled prices also fluctuated.

[32] In June, 1931, with the impact of the depression growing, the rail carriers petitioned the Interstate Commerce Commission for a general freight rate increase of

Such inflexibilities and contrary movements are perverse. They contribute to the unbalance of the price structure and probably enlarge cyclical changes in business conditions. It would be possible to avoid them by consistent use of concepts in regulation which are familiar in unregulated fields: First, in so far as there is any effort to provide a fixed rate of return, this return should be thought of as an average over a period of years, not as a goal to be achieved each year. In permitting the profits of controlled companies to fluctuate as those of other companies do, commissions would be freed from the incentive to make perverse price changes. Second, the concept of normal volume should be introduced into regulation, and rate adjustments should be computed on the basis of normal volume rather than on the basis of actual sales from moment to moment. Thus there need be no accounting ground for the idea that perverse price changes should compensate fluctuations of output. Third, methods should be developed to change controlled prices frequently in accordance with movements of a price index appropriate to the operations of the controlled industry. Flexible pricing, consistent with changes in prices elsewhere, should be accepted as one of the ends of regulation. The effort to keep regulated prices fair should be directed toward maintenance of suitable average and relative levels for the changing prices, not toward preventing price change.

PRECAUTIONS NEEDED IN SEGMENTAL CONTROLS: COORDINATION OF POLICIES

A central difficulty in coordinating policies of segmental control and competition is the fact that, although control policies are matters of formal decision by government, there is no central surveillance over them. Public utilities are regulated by commissions, state and local, throughout the United States, and by a series of Federal agencies, some

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15 per cent. The request was attacked by shippers, who argued that railroad rates had declined considerably less than other prices. The ICC approved a number of "emergency" rate increases, which were expected to provide increased revenue of over 100 million dollars a year. Under the pressure of criticism these increases were discontinued late in 1933. In 1935, however, the railroads again sought a general freight rate increase and the commission again authorized emergency increases comparable to those of 1931. See Merle Fainsod and Lincoln Gordon, *op. cit.*, pp. 274-275, 282-284.

This condition apparently is not common in regulation of electric utility companies. See Irston Barnes, *op. cit.*, p. 559.

operating as independent commissions and some as parts of government departments. Each of the regulatory bodies was created separately by a statute that reflected immediate problems and pressures. In the aggregate these statutes express no broad and consistent policy about the matters common to all systems of regulation. Each of these regulatory bodies is independent of the others. Hence there is great diversity in principles and methods of regulation. Many of the recurring regulatory problems have been successfully met in particular agencies, but there has been no device by which other agencies can be required to adopt the successful techniques. For example, the care with which problems of competition among types of service have been met in the Civil Aeronautics Act has led to no improvement in the handling of these problems by the ICC.

So long as we operate under a Federal system of government, it is not reasonable to suppose that state controls over public utilities can be closely coordinated with one another or with Federal controls. However, coordination of controls at the Federal level can be achieved if it is desired. For this purpose, some of the independence of the various regulatory bodies will need to be sacrificed. Now that regulation is becoming a major function of the Federal government, it can no longer be appropriately carried on through independently organized quasi-judicial, quasi-Congressional agencies, unrelated to the regular executive establishments. Regulation is no longer a side show. Hence there is much to be said for concentration of control activities. In taking such action, however, it is not indispensable to sacrifice the bipartisan character of regulatory commissions or to make the control agencies the creatures of a single political administration, as would be done if commissions became bureaus and their coordinator became a cabinet officer. One possibility would be to entrust the various controls to branches, divisions, or subordinate panels of one or more controlling-policy commissions, and to retain the political independence of the regulatory process by the usual procedures of giving the members of these central commissions long and staggered terms of office and appointing them from both major parties.

Only when some central authority is established will there be anyone responsible for public control who has an incentive to examine the various segmental control activities in order to discover general principles of control and techniques which are generally applicable. Only then will it be possible to require the various control agencies to con-

form to good practice and to relate their respective decisions to one another and to central guiding policies.

ECONOMIC PLANNING

The second broad class of governmental controls consists of comprehensive economic plans intended to improve the performance of the economic system as a whole. In recent years there has been a growing agitation for use of governmental power in this way. The problem of the relation between a competitive policy and over-all planning is a different one from that of establishing a boundary line between competitive and noncompetitive areas.

The planning programs which will be discussed here are those advanced as appropriate to a peace-time economy. With wartime planning we have all recently become familiar. It requires subordination of commercial motives to purposes of patriotism and national survival; establishment of government as principal purchaser of commodities, principal authority in deciding what shall be made, by whom, and where, and principal source of capital funds; rationing of private consumption; comprehensive public price fixing; guidance of private trade by establishment of governmental black lists and preferences; and sometimes even conscription of labor. In time of war public policy is not competitive, though vestigial elements of competition remain in the economy. Moreover, the tight governmental control which is appropriate to war is instituted in progressive degrees as war becomes imminent and is retained in diminishing degrees for some time after hostilities have ceased.

Such periods must be regarded as moratoria in the application of a competitive policy; and there is no blinking the fact that if economic life is to be organized primarily for military purposes, a policy of competition cannot be retained. For this reason peaceful aims and the fostering of international political systems that reduce the threat of war are crucial to the continuance of the competitive policy. However, discussion of this large subject lies outside the scope of this volume.

The significant question here is whether a choice must be made between competition and peace-time economic planning, or whether, alternatively, both policies may be pursued together. In considering this question, the experience of collectivist states is largely irrelevant, for their planned economies were founded upon a repudiation of the

competitive idea. Such competition as has been retained under collectivism is presumably the minimum that any industrial society requires, but there is no reason to think it also the maximum that is possible under planning. Since comprehensive planning under private enterprise is relatively new and remains largely in the project stage, a discussion of its bearing upon competition must necessarily be in large part hypothetical.

PURPOSES OF ECONOMIC PLANNING

Three purposes are frequently proposed as the goals of economic planning under private enterprise. One is to bring about a more orderly and less painful transition when an industry or a geographical area upon which many people are dependent for their livelihood has become chronically stagnant. Another is to reduce the swing of business from prosperity to depression and back again, which has become known as the "business cycle." The third is to minimize unemployment of men and resources in so far as it is not due to the business cycle, and to assure operation of the economy at or near its full productive capacity.

The failures of performance which give rise to such programs are of great importance. The first is crucial from time to time for large segments of society. The second and third are recognized as chronic evils so great as to jeopardize the survival of our economic institutions. These evils have not been averted by competition of the degree and kind that we have actually experienced, nor is there any reasonable prospect that they can be averted by any increase of competition that is practically possible. Therefore, there is a strong case for additional measures and for abandonment of such portions of the competitive policy as may prove to be inconsistent therewith. However, it is possible that, though competition is not a sufficient remedy for such evils, it does something to reduce their impact. Both for this reason and in order to retain the ordinary benefits of competition, public planning addressed to these evils should be kept consistent with the competitive policy so far as practicable.

In the case of each of these recognized evils, various remedies have been proposed. It is no proper part of this book to appraise them all. However, in each case they fall roughly into two groups, of which one can be adopted without serious disturbance to the competitive policy, whereas the other would require that competition be substantially re-

duced and in some respects wholly abandoned. It is appropriate to the competitive policy that the first group of measures be explored first and, so far as practicable, be adopted in preference to the second.

SUCCOR OF DISTRESSED ECONOMIC GROUPS

The problem of the distressed economic group arises when change of occupation becomes imperative rapidly for large numbers of people. The fortunes of particular industries and particular geographic areas are constantly shifting. Changes of taste, new technology, and the appearance of new competition reduce the demand for certain products and require that some persons engaged in supplying these products shift to other activities. Shifts of this kind cause momentary and localized hardship, but they are indispensable to progress in an economic system. However, from time to time more change is required than is readily possible. The difficulty of changing from one occupation to another increases with each increase in the number of persons who must make the change and in the speed with which they must do so, and also with each decrease in the number of alternative job opportunities. Thus geographic areas that are primarily dependent upon raising a single crop or carrying on a single industry cannot accommodate a great shrinkage in that activity, for they have few alternative opportunities; and when the dominant industry is depressed the depression becomes general and forces curtailment of all types of business throughout the region. Solution of such a problem by mass migration to other areas must necessarily be slow, for people are unwilling to leave their homes, and communities are unwilling either to lose their populations or to receive large numbers of immigrants. In such cases local distress is likely to become chronic, to translate itself into low standards of living, and to generate an apathy in individuals and a stagnation in economic institutions such as may perpetuate the evil.

Most of the remedial measures which have been applied and proposed for such situations are based upon restrictions directly in conflict with the competitive policy. They consist of devices to maintain the incomes of distressed groups by fixing selling prices, restricting output, guaranteeing a share of the market, or providing subsidies. The distress of cotton growers in the American South, for example, has been met by measures to peg the price of cotton, to encourage reduction of

acreage and limitation of sales by each grower, and to purchase at high prices large amounts of cotton which are to be stored indefinitely by the Federal government. The economic effects of such a policy are similar to those of price fixing and curtailment of output by a private monopoly.

Moreover, the policy tends to perpetuate the crisis which it is intended to overcome. In so far as it succeeds in maintaining the incomes of cotton growers, it encourages them to continue to grow cotton, discourages shifts into other occupations, and perpetuates the cotton surplus. Indeed, if restrictive measures are ineptly devised, the surplus may be increased.[33] In so far as the restrictions raise or maintain prices, they tend to reduce the consumption of the commodity and thereby to intensify the distress of producers. The essence of such a program is to counteract the corrective influences that competition itself provides—low prices to encourage consumption and low profits or actual losses to reduce production. Though, standing alone, these correctives may be insufficient and painful, merely to get rid of them is to do worse rather than better.

The appropriate public policy in such cases is to facilitate changes of occupation. Where alternative opportunities are lacking, there is need for measures to encourage the development of new industries and to assist distressed persons to enter these new industries. A first step should be to remove any trade barriers or monopolistic privileges by which the economic activity of the distressed area has been prevented from becoming more diversified. In addition, positive assistance may be necessary. Credit may be needed for ventures that are too large and risky to attract private capital. Training programs may be needed to introduce unfamiliar technologies. It may even be necessary to subsidize new industrial ventures during their early stages. Such devices have the great merit that they are not self-perpetuating

[33] Where such a program includes an allocation of shares in the market based upon productive capacity, it encourages expansion of capacity as a device to obtain an increased allocation. Where price-raising measures and subsidies provide incomes which are profitable, expansion is likely to take place under the stimulus of profits. In the Brazilian coffee-control plan, both of these elements were present, and in consequence an enlargement of the coffee acreage continued side by side with progressive increases in the amounts of coffee destroyed by the Brazilian Government, until steps were taken to forbid new plantings. See V. D. Wickizer, *The World Coffee Economy with Special Reference to Control Schemes,* pp. 143-153. Food Research Institute, Stanford University, Calif., 1943.

because they help reduce the problem that evoked them.[84] Though in various respects they substitute public control for competition, they do not destroy competitive safeguards, and they point toward renewed reliance upon competition in the future.

However, in many cases there will still be a transitional problem of distress. Where this is too great to be privately borne, the appropriate remedy is direct relief of distressed persons and groups. A direct relief program selects cases of actual hardship and is automatically terminated when the need disappears, whereas a program of relief through restriction benefits all producers regardless of need and is likely to be indefinitely continued.

CONTROL OF THE BUSINESS CYCLE

Many types of program have been suggested for use in efforts to control the business cycle. Of these, only two raise major difficulties for the competitive policy. One is the proposal that all prices be stabilized in an effort to avert business fluctuations. The other is the proposal that the level of activity in the durable goods industries be stabilized by control over the rate of industrial expansion and the rate of capital replacement.

The former proposal is based on the dubious thesis that the stability of particular prices contributes to stability of production and employment. This idea is supported by the argument that when prices are going down buyers wait for lower prices and thus intensify depression, while buyers hasten to buy when prices are going up and thus strengthen the boom. It is also supported by the more general point that uncertainty of price relationships is a major source of uncertainty and fluctuation in business plans. Although there is some force in both of these arguments, the conclusion that a frozen price structure will lead to industrial stabilization follows logically from neither. When a single concern must adjust itself to changing market conditions, its most obvious alternatives are to adjust its prices or to adjust its output; and so far as it undertakes the one, it need not undertake the other. To prevent price change would be to force all adjust-

[84] In the Havana Charter for an International Trade Organization, which emerged from the conference at Havana, Cuba, early in 1948, an effort has been made to superimpose such constructive policies upon the familiar pattern of the restrictive commodity agreement. See Chap. VI, "Inter-governmental Commodity Agreements."

ments to take the form of changes in production and employment. During NRA the record of industries without price control in reestablishing and maintaining employment was better than that of industries with price control.[35]

It may be argued, however, that even though particular prices should not be entirely frozen there is need for measures to limit the speed and extent of price fluctuations and perhaps to set limits beyond which price change should not go—that we need a compromise between price flexibility and price stability. Whether some degree of decrease in the flexibility of particular prices would contribute anything, and if so how much, to the maintenance of production and employment during a depression, is a controversial question. There is no conclusive evidence showing that anything would be gained; and in the experience of NRA there is abundant evidence of the difficulty of preventing programs that are supposed merely to limit price reductions from being used in fact to abolish them. Moreover, there appears to be no way of diminishing the cyclical instability of a price which does not also reduce its flexibility in relation to other prices. The promise of gain in control of the business cycle is too vague and uncertain to justify the obvious loss in competitive responsiveness which such a program of price stabilization would entail.

Insistence that enterprises should be allowed to meet business problems by price adjustments does not imply rejection of all efforts to stabilize prices. The price flexibility which must be preserved is that of particular prices upon particular products, which must be allowed to move relative to one another. To preserve this type of flexibility is necessary, not only to the maintenance of price competition within an industry, but also to the preservation of the incentives that induce businessmen to reallocate their resources between industries and groups of industries in accord with changing needs. However, no purpose of the competitive policy is served by changes in the general level of prices such as appear in the wake of wars and in the swings of the business cycle. Efforts to prevent this type of price fluctuation are desirable; and so long as they do not take the form of measures to prevent changes in particular prices, they raise no problem for the competitive policy. In general, therefore, fiscal devices to stabilize

[35] See *Report of the President's Committee of Industrial Analysis on the National Recovery Administration,* pp. 163-164. See also Staff Studies, prepared for this committee by the Division of Industrial Economies, *Trade Practices,* Chap. VII.

prices are consistent with the competitive policy, whereas market devices are not.

The second proposal to control the business cycle is more persuasive. There is an impressive weight of evidence to support the view that the business cycle is largely due to extreme fluctuations in the level of activity of the durable goods industries, which in turn are due to the fact that the purchase of capital goods is largely determined by the business outlook.[36] If means could be found to induce businessmen and consumers to buy durables more regularly, business fluctuations would be smaller.

However, it is not clear how public control could be used to bring about this result. Even so drastic a procedure as the licensing of purchases of capital equipment probably would not be adequate; for though it might reduce the rate of expansion during a boom, it would not persuade businessmen to buy goods that could not be profitably used during a depression. Hence the only hope in such a program would be the slender one that if excessive expansion could be avoided subsequent depressions would be less severe; and since forces of decline appear to be cumulative, this influence might easily be insufficient. Against this possibility must be set the great danger that the government might fail to distinguish adequately between healthy and unhealthy expansion and the practical certainty that the government would have to determine not only how much capital goods expansion might take place but also what concerns would be free to grow. The latter type of decision would, of course, substitute governmental determination of the scale of the activity of particular enterprises for determination by the competitive choices of consumers, and would thus be a death blow to the competitive policy.[37]

Other measures for control of the business cycle require no major interference with competition. Public control of central-bank credit policies is well acclimatized in our competitive system, and the idea that credit control may help stabilize the level of business activity has been familiar for a quarter of a century. To concentrate public works in periods of depression and minimize them in boom periods would

[36] See Sumner Slichter, *Towards Stability, the Problem of Economic Balance,* Henry Holt & Company, Inc., New York, 1934.

[37] For an interesting proposal intended to minimize such difficulties, see Morris A. Copeland, "Business Stabilization by Agreement," June, 1944, *American Economic Review,* pp. 328*ff*.

be possible without danger to competitive relationships. To unbalance the government budget for the sake of sopping up money during booms and passing it out during depressions would be similarly without direct effect upon competition. The government has available the entire body of fiscal, compensatory, and inflationary devices, none of which has a serious impact upon market relationships between traders.

FULL PRODUCTION AND EMPLOYMENT

The third objective, that of minimizing unemployment and maintaining high levels of activity, is recent as an accepted responsibility of government, and the proposed remedies are not well defined. It should be noted that a considerable part of this problem would be dealt with if the first two problems were successfully solved, for most unemployment is incident to general business depressions and dying industries. Nevertheless, it is widely believed that our society is plagued by a more or less permanent unemployment which originates in technological progress, in systematic oversaving, or in some other institutional aspect of competitive capitalism.

It is obviously impossible to prescribe the remedy until we know the nature of the disease, and it is not surprising, therefore, that various uncoordinated proposals have been made by persons who, though agreed that unemployment is characteristic of our system, are disagreed as to its origin. It is impossible here to discuss each of these assorted proposals. However, it is clear that most of them are not inconsistent with the maintenance of competition. Persons who deplore oversaving would prevent it primarily by steeper graduations of the income tax. This could be done without altering bargaining relationships in the market. Persons who fear technological unemployment would provide dismissal wages or annual wages as palliatives, a matter which, like all wage policy, is only indirectly related to commercial competition.[38] Apart from such special remedies, it has been proposed that the Federal government adjust its tax policies, its public works programs, and its other spending as may be necessary to maintain sub-

[38] Because of unwillingness to prevent technological progress, few who are concerned with this matter have proposed to curtail the use of new technology. At most, such proposals suggest that means should be found to charge the users of the new device some portion of the costs of labor replacement, through special taxes or through assumption of a duty to provide new jobs for displaced workers. Doubtless such measures would decrease the rate of technological progress, but they would not diminish the competitive character of decisions about new processes.

stantially full employment of man power in the United States. Such a program, like other uses of fiscal or compensatory measures, could be set up alongside of competition. It is also proposed that from time to time the government establish a production budget for the economy, which would set forth the amount of production from each major industry necessary to the maintenance of full employment elsewhere; and that industries be guaranteed against loss in producing the amounts set forth in this budget.[39] This proposal, alone among those that have received public attention, would substantially alter the competitive policy. Even with it in effect, competitive alternatives for individual traders might be maintained. However, the relative scope of different industrial activities would no longer be the result of aggregate private competitive decisions but would be decided by a public body, and the guarantee against loss would not only assure the expected production but also reduce the penalties and bankruptcies imposed upon inefficient concerns by competitive choices. Thus such a policy would preserve certain safeguards against exploitation but would sacrifice a considerable part of the competitive stimulus toward efficiency.

First steps to establish a national policy for full employment were taken in 1946 and 1947 along lines consistent with the maintenance of the competitive policy. Congress enacted the Employment Act of 1946, which declared a continuing Federal policy to use all practical means in order to promote maximum employment and purchasing power in a manner calculated to foster free competitive enterprise.[40] This law provides that at the beginning of each regular session the President shall transmit an economic report to the Congress forecasting the trend of employment, production, and purchasing power, reviewing economic conditions in their effect on this trend, and setting forth a program for maximizing productive activity. Upon the basis of this report a joint Congressional committee is expected to file a report with both houses of Congress containing its findings and recommendations concerning the President's program and setting forth such further recommendations as it may develop. A Council of Economic Advisers is established in the Executive Office of the President to obtain and analyze information and prepare proposed programs for the President's consideration. In December, 1946, the first report of the

[39] See Mordecai Ezekiel, *$2500 a Year,* pp. 199-228, 299-306, Harcourt, Brace & Company, Inc., New York, 1936.

[40] Public Law 304, 79th Congress, 2d Session, Ch. 33, Sec. 2.

Council of Economic Advisers was submitted to the President, and in January, 1947, the President's first economic report was transmitted to the Congress. The report of the newly formed council was devoted largely to a statement of the scope and character of its own task. However, the character of the programs which it will consider was foreshadowed both in its emphasis upon the importance of responsible decision by private enterprises and groups and in its summary of the stabilization devices which are available to the Government acting alone. These devices were described as follows:

". . . It [the Government] must review, as part of a total program, the legal aids and financial subsidies that it has always given to particular branches or phases of transportation, manufacture, trade, and finance, and, more recently, to agriculture and labor. It must gauge carefully the amount and character of public informational, regulatory, and service work the Government needs to perform as a means of preventing fraud, discrimination, or waste, and securing maximum advance in efficiency of operation, particularly among the very small business units, at a minimum of cost. It must consider carefully how much of the national income it shall allow to be channeled into military outlay in view of the nature of dangers and the possibility of physical protection in the light of latest developments. It must decide whether changes in our traditional use of Government agencies in the fields of education, health, and conservation would most surely advance our total production and purchasing power. The timing, volume, and distribution of its own expenditures must be considered in relation to those of private business and State and local governments. The Government must weigh the claim made by some citizens and businessmen that taxation [as such or after the rate has reached some point] is legalized robbery. Or is it being so handled as to be the means by which Government can redress faults in the distribution of total product and the adjustment of these shares to individual or group contributions, faults which tend to keep production below its possible maximum?

"The agents of government must diligently study and vigorously use a democratic and statesmanlike control of the public purse to put a brake at certain strategic points where boom forces develop dangerous trends, and to stimulate employment and production and support purchasing power when and where it becomes unduly depressed. . . ." [41]

[41] Council of Economic Advisers, *First Annual Report to the President,* December, 1946, pp. 17, 18.

The President's economic report which followed this document set forth a statistical analysis of the economic budget of the nation and then submitted a list of recommendations. Some of these recommendations consisted in advice to business and labor groups as to the desirability of moderation in their policies toward prices and wages. The governmental activity which was envisaged included procurement policies designed to avoid stimulating price increases or price maintenance, speedy disposal of surplus war goods, vigorous use of the antitrust laws to eliminate price abuses, extension of emergency rent control, increase of the minimum wage, extension of the coverage of the Fair Labor Standards Act, increase of benefits under the social security system, institution of a Federal long-range housing program, avoidance of tax reductions, and adoption of various laws designed to cope with strikes and with abuses by labor organizations.[42] In support of this immediate program, the President recommended long-run policies or studies in anticipation of the formulation of policies to improve productive efficiency through industrial training; to coordinate state employment services; to prevent discriminatory employment practices based upon race or religion; to keep farmers' incomes at a level comparable with those of other groups (so far as possible without using subsidies and with increased flexibility); to maintain and possibly extend food and nutrition programs for low-income families; to improve agricultural marketing practices; to provide Federal support for farm education, housing, and other social services; to foster regional economic development through such measures as stimulating the production and distribution of low-cost hydroelectric energy, developing flood control and navigation, improving roads, draining and irrigating land, enforcing fair and competitive rates of transport, and removing barriers to truck transport; to revise standards for Federal grants-in-aid; to stabilize public works construction according to our long-term needs; to devise a uniform patent policy for federally financed research; to strengthen the antitrust laws and provide more resources for their enforcement; to facilitate the availability of long-term credit and equity capital for small enterprise; to coordinate social insurance programs with programs for the maintenance of the economy's purchasing power; to extend the benefits of social insurance; and to establish in-

[42] *The Economic Report of the President to the Congress*, Jan. 8, 1947, pp. 20-22 and Appendix C.

ternational trade under the principles of the proposed International Trade Organization.[43]

It is not part of the function of this chapter to discuss the merits of the various points in the President's program or to appraise the adequacy of the program to accomplish the broad purposes to which it is directed. Whatever appraisal may be appropriate along these lines, it is obvious that the program as a whole proposes various fiscal measures and public projects as compensatory devices to reduce the fluctuations of the economy and various modifications of the boundary between the controlled and competitive areas of the economy. The program includes proposals designed to make competition more vigorous within the competitive area. There is no fundamental conflict between such a program and the competitive policy.

In the aggregate, programs of economic planning are less inconsistent with the competitive policy than is popularly supposed. Those that adopt the techniques of private monopoly are directly contrary to that policy, but for the most part they also appear to afford ineffective means of accomplishing the purposes for which they are proposed. Programs that rely upon fiscal or compensatory action by the government can usually be applied or rejected upon their own merits without substantial concern about their effects upon competition.[44] Programs that require central decision about the scale or character of the activity of particular industries and enterprises are, to varying degrees, inconsistent with the competitive policy.

Sweeping assertions that planning is inconsistent with competition are usually based upon the belief that competition should be relied upon to provide an economic equilibrium and that maintenance of competition should constitute the whole governmental policy toward business. As has already been pointed out, the role of competition is more modest than this. Competition is a major part of public policy but not the whole of it. It can and should be maintained in its appropriate place, even by a government that takes substantial responsibility for the stability of the economy and for the level of business activity.

[43] *Ibid.*, pp. 24-32.

[44] However, there is a possibility that financial aid by government will be used to maintain production and employment in a particular industry in spite of monopolistic restrictions which flourish there; and if so, the public assistance may, in effect, subsidize the private monopoly and thus weaken the competitive policy. Something of this kind appears to have occurred in the building industry. Fiscal and compensatory programs should supplement rather than replace efforts to preserve competition.

VIII. ADMINISTRATION

PREVIOUS CHAPTERS have discussed the substantive content of the competitive policy and its relation to policies of government control. This chapter will deal with the administrative techniques appropriate to make the competitive policy effective.

In view of the substantive inadequacy of the present law to cope with undue concentration of economic power and of the inherent complexity of the policy problems in this field, there is no great reason for wonder that large-scale enterprise has not been effectively dealt with under the antitrust laws; but there is ground for surprise that the substantive law has gone so long without improvement. Moreover, in view of the soundness of the basic law of collusion, there is need to explain the persistence of collusive activities and the perversity with which exceptions to the policy against collusion have been framed so that they partially defeat its purpose. That discrepancies and conflicts in policy represent partial victories for conflicting interests and conflicting ideologies is obvious, but there is evidence of defective administrative organization in the fact that although the policy of competition is politically dominant, those who support it have not been able to make their will systematically effective.

Two basic difficulties have weakened the administration of the competitive policy. The first is the fact that there has been no central responsibility for applying it, and hence no coordinating mechanism to keep the activities of government consistent with it. The second, consequent upon the first, has been failure to envisage the administrative needs of the policy and consequent failure to apply and enforce it upon an adequate scale. In order to see clearly the significance of these difficulties, it will be necessary to consider first the administrative functions that are inherent in the policy of competition which has been sketched in previous chapters.

ADMINISTRATIVE REQUISITES OF THE COMPETITIVE POLICY

The first and most obvious necessity in a competitive policy is to prevent private restraints upon trade, both collusive and monopolistic.

This requires investigation on a scale adequate to detect such restraints wherever they become important; prosecution and punishment under the antitrust laws on a scale sufficient to maintain a general belief that lawbreakers will be caught and punished; remedial proceedings under the antitrust laws sufficient to reorganize or dissolve monopolistic business enterprises and those business associations through which collusive or coercive activities are carried on; formulation of suitable plans as to the nature of such reorganization; and administrative surveillance over reorganized enterprises and associations, sufficient to assure the adequacy of the remedial action taken. Failure to detect and prosecute violations of law removes the hazard from lawbreaking, places the concern that obeys the law at a disadvantage, and induces an increasingly general noncompliance. Where the impairment of competition is due to the structure of business enterprises or the inherent character of the activities of business associations, failure to formulate specific corrective measures and enforce them means that competition will remain ineffective in spite of ostensible compliance with the law. Failure to keep watch over the corrective measures taken will result in false confidence wherever the original program to restore competition was inadequate and wherever the enterprises concerned have found new ways to accomplish their former purposes.

A second administrative requisite is that an agency devoted to the competitive policy and well informed about its implications should prepare from time to time legislative recommendations designed to perfect that policy and to assure the propriety of exceptions to it. The functions of such an agency should include both formulating new legislation and advising about legislation proposed by others. To perform these functions adequately, the agency should be continuously engaged in study of the effects of the competitive policy as currently applied and in research relevant to problems which are arising under that policy. The scope of the agency's recommendations should include improvements of procedures under the antitrust laws; modification and extension of the substance of the antitrust laws, particularly with reference to the power of big business; modification of other general laws to make them consistent with the competitive policy, particularly the laws that have to do with corporate organization and patents; regulation of portions of the economy in which competition is obviously impossible or fails to produce satisfactory results; and provision of safeguards equivalent to those of competition in parts of the economy where competitive safeguards are not applied. In many fields the

jurisdiction of such an agency cannot be exclusive. In the case of patent laws, for example, agencies of government concerned with scientific progress will necessarily have a substantial voice in the formulation of legislative policy; and the agency administering the regulations in a noncompetitive area must necessarily carry the chief responsibility for legislative proposals about that area. In such cases, however, the effect of what is done upon the policy of competition should not be ignored, and analysis of this effect should be entrusted to persons responsible for the competitive policy rather than to other persons.

A third requisite of a policy of competition is the provision and administration of safeguards for the interests of buyers and sellers equivalent to those of the competitive policy in parts of the economy where regulation has replaced competition. These safeguards may differ in character from case to case; and in any one case there is need to keep them consistent with the purposes and techniques of the particular system of regulation of which they are a part. Nevertheless, there is also need to keep the entire array of such safeguards consistent with the competitive policy in their purposes and effects. Care should be taken that they actually give to the consumer and, where monopoly has not been accepted as a part of the regulation, to the small businessman, protection which is as comprehensive as competition would give. Care should be taken that this protection extends throughout the field in which competition has been set aside so that no man's lands are not created and so that the boundary between competition and control is clear and well established. To assure such results, persons responsible for the competitive policy should have a voice in devising these safeguards and in applying them. Many different degrees of responsibility for regulatory activities might be entrusted to those who administer the competitive policy. At the extreme of modesty, a formal liaison or advisory relationship might be set up. At the other extreme, each regulation of commercial undertakings might be regarded as a branch activity of a ministry of economics which would be fully responsible for administering the competitive policy. It is not necessary here to choose the degree of responsibility which would be appropriate. It is sufficient to say that means should be found to make the regulatory safeguards consistent with the safeguards of competition.

A fourth requisite of the competitive policy is that the manifold administrative decisions of government be made with the purposes of the competitive policy in mind. The scope of governmental activity is now so broad and the discretion of many government officials so

great that much can be done to strengthen or weaken competition in making day-to-day decisions that are not formally regulatory in nature. The government lends money to business enterprises; negotiates with foreign governments about tariffs, trading privileges, and the right to do business abroad; informally encourages and discourages international contracts between business enterprises; initiates programs of public works; carries on technological research; and in many other ways takes action that may promote or thwart the interests of particular business groups. If those responsible for such activities fail to keep the competitive policy in mind as one of the governmental purposes with which their acts must be consistent, they may do much to weaken competition. They may grant leases and loans to monopolistic enterprises rather than to small concerns. They may do research which supplies the information desired by big business enterprises rather than that desired by their smaller rivals. They may support the aspirations of great domestic enterprises abroad without regard to the effect of these aspirations upon competition in foreign trade or in the domestic market. Conversely, consistent attention to the purposes of the competitive policy may weaken monopolistic concerns by depriving them of government support and assistance in proportion as they become greater threats to competition.

Since the competitive policy expresses only one of the purposes of government, it cannot be expected to be decisive at all times in matters such as have just been mentioned. Negotiations about loans obviously depend upon the solvency of the borrower and the desirability of the project, as well as the borrower's power. All appropriate aspects of public policy must enter into an administrative decision, and where the aims of policy are in conflict, no single public purpose can be expected always to outweigh all others. However, though the policy of competition may sometimes be subordinated, it should never be ignored. Government officials should be kept aware of its existence and of its implications for their work. This calls for systems of liaison, clearance, and coordination similar to those that are used in minimizing the conflicts between other policies of government. It calls for a procedure by which, when conflicts of policy prove inevitable, decisions can be taken at a high administrative level.

A fifth requisite of the competitive policy is to make sure that the activity of private litigants does not falsify issues before the courts and thus bring about improper development of the laws supporting competition. Under the antitrust laws, private persons may recover triple

damages from violators of the law. There is likewise a place for private adversary proceedings under various regulatory statutes. Judicial decisions in private cases become precedents as readily as in cases to which the government is a party, but whereas issues of public policy and of the relation of the public interest to private rights are paramount in litigation between private persons and the government, the issues raised by private litigants lie between two sets of private interests. Relevant aspects of the public interest are often ignored or deliberately obscured by private litigants; and such issues of public policy as are raised may be discussed incompetently or without adequate information. Where the public interest is affected by the way in which a legal issue is presented in private litigation, a government agency may request the court to be allowed to appear as *amicus curiae* to present its views as to the bearing of the law upon the particular case. By doing so, it can make sure that considerations it regards as important to the public interest and to a proper interpretation of the law are not obscured or overlooked. Procedures for undertaking this type of interference are appropriate to the administration of the competitive policy. If they are to be used effectively, there must also be procedures to inform the government about the initiation of private suits which raise significant problems.

A sixth requisite of the competitive policy is that the legislative policies of states and municipalities be influenced, so far as possible, toward patterns consistent with competition. The most obvious needs are to make state antitrust laws adequate to deal with local restrictions of competition with which the Federal government cannot cope and to eliminate state and local laws that set up barriers designed to exclude certain groups from certain markets. In particular cases in which state and municipal legislation imposes unreasonable restrictions upon interstate commerce, Federal agencies may be able to call the attention of Congress to the restrictions and to suggest enactment of overriding national laws, or they may have opportunity to challenge the constitutionality of the restrictive laws in the Federal courts. But so long as our Federal system exists and the commerce power of the Federal constitution is interpreted as at present, the authority of the Federal government will be insufficient to meet the problem merely by enforcing a Federal policy toward interstate commerce. The principal means of action must be to persuade the states to adopt nonrestrictive policies and to use their power over their municipalities toward the same end. Such a program requires information about

the character of state and local legislative programs and procedures for continuous exchange of views with the states. It may entail formulation of legislative standards expressed in model laws; organization of joint committees of the Federal and state governments; and encouragement of cooperative action by the states to consider trade-barrier problems through such instrumentalities as the Council of State Governments.

The various types of action that have been indicated above should be effectively coordinated. A central policy should guide prosecutions, review of proposed legislation, formulation and review of administrative safeguards for regulated segments of the economy, efforts to make the ordinary activities of the government consistent with competition, advice as *amicus curiae,* and cooperation with state governments. Without central responsibility, some of these activities will not be undertaken and others will be sporadic, badly timed, and inconsistent with one another. Because of the breadth and difficulty of the problem of maintaining competition, the need for coordination of the work appropriate to it is at least as great as that for coordination of policies having to do with agriculture, labor, Federal loans, or social security.

EXISTING DEFECTS: LACK OF COORDINATION AND INSUFFICIENT ACTIVITY

In the absence of a central coordination, the competitive policy of the United States has contained little more than laws and procedures for the prosecution of monopolies, unfair methods of competition, and combinations in restraint of trade. Even such punitive activities have been divided among several agencies. The Antitrust Division of the Department of Justice has carried complete responsibility for the enforcement of the Sherman Act except in so far as various other agencies—for example, the Secretary of Agriculture, the Secretary of Commerce, and the ICC—can grant immunity from the provisions of the Sherman Act to arrangements which they respectively approve under permissive statutes. The FTC has carried similar responsibility for enforcement of the Federal Trade Commission Act, as well as primary responsibility for the enforcement of the Clayton Act. Portions of the responsibility under this latter statute have been assigned, however, to the ICC and the Federal Reserve Board. Odds and ends of legislation under which restrictive practices may be punished or exemptions from

the antitrust laws may be granted are administered by a considerable number of different bodies: for example, the Federal Power Commission, the Federal Communications Commission, the Commodity Exchange Administration, the Securities and Exchange Commission, the Civil Aeronautics Board, and the President of the United States.

This division of authority is largely responsible for major weaknesses in the scope and character of the American competitive policy. No single agency has had either the power or the opportunity to survey the whole problem of maintaining competition in the light of all the means available and to determine authoritatively the scope of the program necessary to this end. The various agencies have established their various enforcement programs on a scale determined partly by custom and partly by the play of bureaucratic and political forces at one point within a government structure. Without central responsibility or long-run plan for the administration of the competitive policy, the government has had inadequate knowledge of the extent of private restraints of trade and has developed no comprehensive program for the termination of these restraints. Without clear vision of the objective, incentive has been lacking to determine on a long-run basis the resources necessary to accomplish this objective. Hence the resources actually used have been chronically insufficient. At no time in the history of the laws have there been enough people engaged in enforcing them to permit the enforcement agencies to investigate promptly all major charges of violation and to take prompt action in the courts wherever such a charge appeared to be true. Until the last ten years, there has been insufficient staff to enable these agencies to investigate and try enough cases to convince the business community that violation of the law is hazardous. In earlier years prosecutions were merely symbolic in character. In any one year, from half a dozen to a dozen instances of law violation were arbitrarily selected for investigation and trial [1] because of the importance of the defendants, the political ripeness of the issue involved, or the significance of the question of law upon which the decision would turn. With all available resources committed to these few cases, the enforcement agencies were helpless to undertake new work, and in consequence the prosecution of a few lawbreakers became in effect a guarantee of immunity to the rest. It was inevitable that the meager resources should be used primarily in attempting to prevent relatively obvious types of restriction, and for

[1] See pp. 296-297.

this reason many significant and controversial issues were systematically ignored. It was inevitable, too, that token law enforcement should appear to its victims as discriminatory, and to the general public as having little practical connection with the maintenance of free markets. Thus the effect of limited enforcement was to discredit the fairness and effectiveness of the antitrust laws.

Under these circumstances the antitrust laws came to be widely criticized. Proposals for their repeal or weakening became general during the 1920's.[2] Nevertheless, even without systematic enforcement the laws had a substantial effect. They made it necessary for monopolistic and collusive restraints of trade to be nominally secret. They prevented any general endorsement of such arrangements by public authorities or responsible business organizations, and forestalled most efforts to make participation in private restrictions compulsory or to give legal sanction to private or public disciplinary action against nonparticipants. Thus they prevented the appearance in the United States of a formally organized and state-supported cartel system, such as became well established in various European countries before the Second World War. Moreover, there is reason to believe that they diminished the frequency and severity of collusive restraints upon trade. This assertion cannot be proved by quantitative comparisons, for in the nature of the case the scope and effectiveness of collusion in the United States remained partly unknown. However, various instances have come to light in American antitrust investigations in which American businessmen insisted upon more secret and more

[2] See, for example, recommendations submitted to the National Civic Federation's Commission on Industrial Inquiry, Dec. 10, 1929. Suggestions included (1) outright repeal of the Sherman and Clayton Acts; (2) that the acts be amended to permit greater cooperation among competitors; (3) that the criminal provisions of the Sherman Act be eliminated; (4) that Federal agencies or courts be authorized to approve proposals for cooperation among competitors and thereby exempt such schemes from the antitrust laws; (5) that the antitrust laws be amended to allow producers and manufacturers of natural resources of all kinds to enter into agreements to curtail or regulate production, thus maintaining stable market values; (6) that trade associations be granted greater authority in compiling and disseminating statistics, trade, and cost information. (National Civic Federation, New York, Jan. 20, 1930.) See also "Anti-trust Law Amendments Suggested by Bar Committee, American Bar Association," *United States Daily,* Aug. 5-7, 1930; and address by Oscar Sutro, vice-president and general counsel, Standard Oil Company of California, delivered at Antitrust Law Conference, New York University, Oct. 26-27, 1931, New York University Bureau of Public Information release, Oct. 28, 1931.

roundabout restrictions than were desired by their European colleagues and gave the antitrust laws as the excuse for their caution. In particular industries in which comparisons between American and European producers are possible, European prices have been kept higher, European quality has lagged, and European technology has been retarded.[8]

It is remarkable that, in spite of decades of token administration, the announcement of a vigorous enforcement policy in the late 1930's was greeted with enthusiasm by Congress and by the American people. The vigorous survival of the antitrust tradition, in spite of the record of inaction in applying it, is evidence of its vitality.

Effective enforcement of the antitrust laws does not require that every case of law violation be caught and punished. In all legal proceedings there is a dramatic element which is relied upon to discourage breaches of the law by persons who are not before the court. So long as lawbreaking is hazardous enough to make the community avoid it, and so long as major breaches are discovered and terminated so rapidly that they do not accumulate in an ever-growing abandonment of the competitive pattern, enforcement may be called adequate. It is essential to a program on this scale, however, that the enforcement agency have sufficient resources at its disposal to prevent illegal restrictions from being encouraged by a belief that there are no means to cope with them.

It is impossible to estimate at this time the scale of enforcement that would be appropriate to a full application of the competitive policy. The insufficiency of enforcement prior to 1938 left an accumulation of restraints which had not been cleared away at the outbreak of the Second World War, and it appears probable that some of these retraints, together with others developed during the war, still afford an enforcement problem larger than that which would remain after some years of vigorous activity. It is clear that the maximum personnel employed by the Department of Justice and the FTC before the war

[8] A striking price comparison is available for electric lamp bulbs, which have been subject to restrictive controls in both Europe and the United States. Under the international lamp cartel the lowest European price for 25-, 40-, and 60-watt bulbs was 20 per cent above the corresponding American price. The average European price for 25-watt bulbs was 165 per cent of the American price, while for the 40- and 60-watt bulbs the average European prices were approximately 215 per cent and 265 per cent of the American prices, respectively. See U.S. Tariff Commission Report No. 133, 2d Series, *Incandescent Electric Lamps,* 1939, p. 49.

EXTENT OF FEDERAL ANTITRUST-ENFORCEMENT ACTIVITY *

Fiscal year	Antitrust Division expenditures	FTC total expenditures	Antitrust Division, cases started	FTC cases of restraint decided
1891	....	....	1	
1892	....	....	4	
1893	....	....	2	
1894	....	....	0	
1895	....	....	4	
1896	....	....	2	
1897	....	....	3	
1898	....	....	1	
1899	....	....	1	
1900	....	....	0	
1901	....	....	0	
1902	....	....	2	
1903	....	....	2	
1904	....	....	1	
1905	....	....	1	
1906	....	....	10	
1907	....	....	13	
1908	....	....	15	
1909	....	....	1	
1910	....	....	11	
1911	....	....	15	
1912	....	....	29	
1913	....	....	27	
1914	....	....	11	
1915	....	$ 100,000	12	
1916	....	395,000	3	
1917	....	474,000	12	3
1918	....	1,423,000	18	10
1919	....	1,507,000	4	13
1920	....	1,036,000	10	19
1921	$ 147,000	880,000	22	6
1922	180,000	901,000	21	69
1923	184,000	971,000	19	32
1924	194,000	979,000	11	24
1925	196,000	1,008,000	13	54

EXTENT OF FEDERAL ANTITRUST-ENFORCEMENT ACTIVITY—(*Continued*)

Fiscal year	*Antitrust Division* * *expenditures*	*FTC total expenditures*	*Antitrust Division, cases started*	*FTC cases of restraint decided*
1926	216,000	995,000	12	34
1927	200,000	961,000	15	14
1928	198,000	968,000	18	11
1929	204,000	1,159,000	18	7
1930	204,000	1,465,000	12	16
1931	204,000	1,848,000	5	13
1932	204,000	1,779,000	3	3
1933	150,000	1,399,000	7	6
1934	154,000	1,314,000	10	5
1935	414,000	1,956,000	10	15
1936	420,000	1,822,000	4	19
1937	435,000	1,894,000	9	28
1938	414,000	1,942,000	10	35
1939	789,000	2,197,000	12	33
1940	1,309,000	2,275,000	114	51
1941	1,324,000	2,226,000	54	86
1942	2,325,000	2,341,000	97	21
1943	1,800,000	2,133,000	58	23
1944	1,760,000	1,957,000	22	45
1945	1,540,000	1,998,000	24	18
1946	1,875,000	2,163,000	26	32
1947	2,134,000	2,862,000	44	9

* Expenditures of the Antitrust Division are drawn from the annual reports of the Attorney General. The Federal Trade Commission's expenditures are not reported by type of case. Hence figures for total expenditures have been used, taken from the commission's annual report for 1947; but the larger part of these expenditures goes, not to preserve competition, but to keep it fair by attack upon misrepresentations and similar types of unfair competitive practice. The expenditures also cover work on trade practice conferences and economic reports.

Since the Antitrust Division is a prosecuting agency, the best measure of its activity is the number of cases instituted before the courts. The figures given, except that for 1947, which was supplied directly by the Department of Justice, are based upon lists of cases submitted by the Division to the House of Representatives Committee on Small Business. They overstate the amount of activity; for where a single offense gave rise to both a criminal case and a civil case, it is recorded as two separate proceedings. [See *United States versus Economic Concentration and Monopoly*, staff report to the Monopoly Subcommittee of the House Committee on Small Business, pursuant to H. Res. 64 (79th Congress), pp. 276-289.]

Since the FTC is a quasi-judicial agency, the best measure of its antitrust activity is the number of antitrust cases which it has decided. The figures given prior to 1932 were compiled by the writer through analysis of the bound volumes of FTC decisions. Because of difficulty in classifying certain cases, they should be regarded as approximate rather than exact. The figures from 1932 to 1947 are based upon lists prepared by the commission for the House Committee on Small Business (referred to in *ibid.*, p. 20). Because of revisions in the lists after the report of the House Committee was published, the numbers of cases reported here differ from those given in the committee's report.

was still insufficient to its assigned task. In the FTC, proceedings against major restraints of competition were deferred for lack of man power. In the Department of Justice, investigations of segments of the economy were postponed in order to do intensive work in other segments. At a rough guess, the work in sight would have required a staff approximately four times the size of that employed. If staff had been provided to clear away the accumulated restraints, it is probable that fewer people would have been needed thereafter to police new ones. However, even permanent establishments four times the size of the previous staff[4] would mean only about 1,250 persons for the Antitrust Division, less than the number employed by the FCC,[5] and 2,675 for the FTC, substantially less than the ICC.[6] Total personnel for the two organizations under these conditions would mean a staff only twice that of the police force of the District of Columbia.[7]

EXISTING DEFECTS: INADEQUATE PROCEDURES IN LITIGATION

The absence of central coordination of policy is also largely responsible for a second difficulty: the use of litigation as the primary, and indeed almost the sole, instrument in developing and applying the competitive policy. In the absence of a well-formulated and coherent plan for administering the competitive policy, there has been no careful consideration of the appropriate part that should be played in this policy by lawsuits as distinguished from other devices of control. Since the antitrust laws constitute the only broad and specific statements of competitive objectives behind which lie agencies whose chief duty is to accomplish these objectives, the enforcement of the antitrust laws has been regarded, not as a part of the competitive policy, but as substantially all of it. The endeavor has been to give effect to a broad economic program through prosecutions before courts and quasi-judicial commissions. As has already been indicated in previous pages, there is much to be said for this method. Its punitive and corrective character is capable of maintaining a respect for the law. It dramatizes

[4] *The Budget of the United States Government,* 1942, pp. 651-652 and pp. 68-70.

[5] *12th Annual Report of the Federal Communications Commission,* June 30, 1946, p. 2.

[6] *The Budget of the United States Government,* 1948, pp. 57, 58, 101-105 (actual, 1946).

[7] See *Report of the Government of the District of Columbia,* June 30, 1946, p. 94.

the issues of policy in a way that obtains a substantial degree of law observance even when the scale of enforcement is flagrantly inadequate. It brings to the support of the competitive policy the strong tradition that laws must be enforced and obeyed and thus safeguards the policy against attacks by vested interests. Its procedure case by case affords a compromise between inflexible rules and opportunistic acquiescence in the results of changing economic circumstances. The so-called "rule of reason" which the courts apply permits them to take some account of economic fact and analysis under the varying circumstances of a far-flung industrial system.

Nevertheless, litigation is in many respects inappropriate to the function which it is asked to perform in the antitrust laws. The central concept of a lawsuit is that the issues concern the relations of those immediately before the court, to the exclusion of outsiders. Indispensable as such a view is in the adjudication of private controversies and the punishment of persons for ordinary torts, it is inadequate to circumscribe the phenomena of restraint of trade. The significance of a restraint lies in its effect, and hence largely in its setting. The character of the public policy appropriate to it depends largely upon whether it stands alone or is one of a large number of similar restraints. Hence much that is irrelevant at law is highly relevant to public policy.

Moreover, antitrust cases must be litigated in a context of legal concepts derived from private disputes. These include the preconceptions that one side must be right and the other wrong, that wrongdoers should be punished, and that punishment and orders by the court can take the place of continuous surveillance, negotiation, and compromise. In practice, these ideas are often inappropriate to an economic policy. They are modified by the prosecutor, who exercises an unusually wide discretion in selecting his cases and who frequently resorts to informal negotiations between prosecution and defense in which the decision of the court is regarded by both sides as a bargaining weapon rather than a determining pronouncement.[8]

Furthermore, lawsuits are contests in which prosecution and defense both play to win and in which victory is substantially influenced by technical rules. In this process there is danger that no one will be-

[8] See *Hearings* before House Judiciary Committee, 75th Congress, 3d Session, with Regard to the Official Conduct of Judge Ferdinand A. Geiger, U.S. District Judge for the Eastern District of Wisconsin, pp. 5-6, 7-11.

come fully aware of the true issues of public policy. Rules of evidence which were developed for relatively simple activities that bystanders could directly observe are often inappropriate in tracing the ramifications of a far-flung conspiracy or an intricately woven business structure. Business entities are likely to be regarded as legally separate persons even though they are notoriously bound together in communities of interest.[9] Statistics may be hearsay, and what everybody knows may not be evidence.[10] Much of the evidentiary material which businessmen use in arriving at their policies would be regarded as incompetent or irrelevant if it were offered to prove the same facts in court. Even in the use of expert testimony, witnesses are selected by each side for their probable favorable bias and are examined along lines designed to bring out only those parts of their views that are favorable to the examiner; and, consequently, the court seldom obtains the benefit of whatever agreement there may actually be among experts. Trial of an antitrust case may easily become too long and complex to be intelligible to a jury; and even judges may find the record bewildering. A judge may be furnished the services of a law clerk to help him explore the complexities of the law, in which he is already learned; but in bringing out and understanding the facts, he has lacked a similar service from an impartial economic analyst. In 1945, for the first time, Federal judges obtained the authority to appoint expert witnesses on their own motion.[11]

Apart from these major difficulties in the process of litigation, certain of the procedures of criminal and civil suits are inappropriate in

[9] For example, although the court considered the Aluminum Company of America and Aluminium Limited of Canada to be separate entities [*United States v. Aluminum Company of America et al.*, 148 F. (2d) 416, 441], the former caused the latter to be incorporated in Canada in 1928 and transferred to it most of its business and holdings outside of the United States. In return Aluminium Limited issued all of its capital stock to Aluminum Company of America. This stock was distributed proportionately among the latter's stockholders, with Andrew W. Mellon, R. B. Mellon, and Arthur V. Davis receiving more than 50 per cent. The same persons held the majority of the capital stock of Alcoa. See *United States v. Aluminum Company of America et al.*, Petition filed Apr. 23, 1937, Southern District of New York, par. 72.

[10] For a brief résumé of the difficulty in establishing statistical information as acceptable evidence in the aluminum case, see Corwin D. Edwards, "Can the Antitrust Laws Preserve Competition?" *American Economic Review* Supplement, Vol. 30, No. 1 (March, 1940), p. 173.

[11] Federal Rules of Criminal Procedure, Rule 28, as revised in 1945.

antitrust cases. In criminal procedure it is unduly easy for the prosecution to obtain an indictment,[12] which in itself has a punitive effect upon a defendant who may not be found guilty. After the indictment, advantage lies with the defense because of rules that the violation of law must be proved beyond a reasonable doubt and that the prosecution may not appeal an acquittal by a lower court. Moreover, a jury may be reluctant to convict the defendants in an antitrust case, who are usually well dressed and conventionally respectable. This reluctance reaches its peak when the facts in the case are too complicated to be easily understood or when businessmen on the jury are themselves engaged in practices like those of the defendants.

In civil cases under the Sherman Act, the Department of Justice has no right to subpoena evidence, and in consequence there is inadequate opportunity for investigation unless the case follows a grand jury investigation appropriate to a criminal proceeding.[13] The chances of the civil trial are better balanced than those of a criminal proceeding, for in civil suits the government's case need be proved only by a preponderance of evidence and either side may appeal an adverse decision. An outstanding weakness of a civil proceeding, however, lies in the remedy afforded by a favorable verdict. No penalties may be inflicted. The judge enters a decree which he regards as adequate to prevent continuance of the offense. But whereas long preparation and extended trial in court precede decision as to guilt, there is no systematic preparation nor extended public discussion of issues in the formulation of a remedy. Typically, the judge's decree is the result of negotiation between prosecution and defense, in which the defense relies upon its intimate knowledge of its own business, whereas the government has only the information that it assembled in order to prove guilt. Consequently, judicial remedies in civil cases are likely to be ill conceived. Moreover, there is no suitable procedure for administrative surveillance of the decree to determine whether it is effective. Efforts have been made by statute to remedy these defects of the civil suit by

[12] In TNEC Monograph No. 16, *Antitrust in Action,* Walton Hamilton and Irene Till analyze the weakness of the defense's position in antitrust grand jury hearings and conclude: "Nominally, the grand jury has the power to indict or refuse to indict; in reality it usually does the will of the prosecuting attorney, into whose hands the real discretion has passed." (P. 53.)

[13] By contrast, in proceedings under the Clayton Act and the Federal Trade Commission Act, the Federal Trade Commission has the equivalent of the subpoena power.

giving the FTC the duty to help formulate decrees and to report upon their consequences when asked to do so, but these powers have scarcely been used. Presumably their ineffectiveness is due to the fact that the commission is remote from the court which carries the responsibility, and that hence neither the court nor the commission feels inclined to insist that the commission undertake this work.

The FTC's quasi-judicial methods of adjudication avoid some of these difficulties, but they have their own special defects. The commission is theoretically a bipartisan board of experts, equipped with broad powers of subpoena and with economic as well as legal staffs. It is authorized to act as both complainant and judge. Its presumed expertness points to an apparent intention that it should explore the frontiers of the law and break new ground in developing public policy. As would be appropriate in such pioneering, it is permitted to require lawbreakers to cease and desist from their activities but not to punish them unless they stubbornly continue to do what has been forbidden.

The commission has been truly bipartisan, but commissioners have seldom been selected for special familiarity with problems of trade regulation. Such expertness as they have possessed has usually been developed after they have assumed office. The commission's duty of pioneering has sometimes been performed well. However, the courts have not been receptive to departures from the main channel of the law by a commission that has legal pretentions but is not wholly judicial, and the necessity of obtaining agreement among five commissioners has also made bold action difficult. Reinforced by the professional training of the commission's lawyers and their desire not to be overruled by the courts, these influences have kept much of the commission's work legally conventional. Many of the most daring innovations in prosecuting policy and legal interpretation have been made in recent years by the Department of Justice rather than by the FTC.

In conventional litigation the commission has been weak because of the limits imposed by law upon its powers of enforcement. These limits are apparently inevitable as protections against abuse of the commission's dual role as prosecutor and judge, even though they may be inappropriate to that part of the work that involves no pioneer function. Until recently the commission's orders were not enforceable until they had been violated, confirmed by a court, and again violated. Thus three successive breaches of the law preceded any penalty. This is still true of violations of the Clayton Act. Recent amendment

of the Federal Trade Commission Act has left it still necessary to prove two violations of that statute before a penalty is imposed.[14] Moreover, the commission's orders are narrower than those that can be issued by a court of equity, for whereas the court may both prohibit and require action by defendants, the commission may only order defendants to cease and desist from specified types of activity.

Some of the defects that have been noted above are inherent in litigation. Others, however, might be alleviated or done away with. There is no insuperable obstacle to use of the FTC to explore legal frontiers. By amendment of the law the commission could be given better teeth. New legislation could give the courts better facilities for preparing and supervising decrees in antitrust cases or could entrust these tasks, as distinguished from formal promulgation of decrees, to a more appropriate agency, such as the FTC. In either case, legislation could provide specifically for appropriate investigations designed to help make and enforce decrees. Legislation to provide a severe civil penalty could make lawbreaking more hazardous. Provision of subpoena power for use in civil cases could make effective investigation possible without the necessity of using grand juries which look toward criminal prosecution. Something might be done to liberalize the rules of evidence in antitrust cases, as the rules of pleading have already been liberalized in the preparation of antitrust indictments and complaints.[15]

[14] Amendment of the Federal Trade Commission Act in 1938 provided that the commission's cease and desist orders are to be considered final unless appealed within 60 days, and levied penalties not to exceed $5,000 for each violation of a final order. In case of appeal a judicial order replaces that of the commission, and violation of this order leads to proceedings for contempt of court. In either case, this shortened procedure establishes penalties only for the second offense. See Federal Trade Commission Act, as amended by Act of Mar. 12, 1938, and by Act of June 23, 1938, 52 Stat. 111 (1928), 75th Congress, 3d Session (15 U.S.C.), par. 44. See also Federal Trade Commission *Annual Report*, 1938, p. 3.

[15] For example, in *United States v. The American Tobacco Company et al.* (Criminal No. 6670), the defendants applied for a bill of particulars on the ground that the charge was allegedly "so indefinite and so lacking in particularity that the defendants are not apprised of the offenses claimed to have been committed by them and that they are consequently unable to prepare their defense." The appellate court ruled: "Since the alleged scheme covered a wide field, and the charge, numerous shifting elements, it was impossible to set forth all the facts specifically and definitely; and in such a case more than a general description of its nature being impossible, such a description is, accordingly, sufficient." [147 F. (2d) 117, par. 41, 42.] On appeal the Supreme Court affirmed the appellate court decision. See *The American Tobacco Company et al. v. United States,* 328 U.S. 781 (1946).

Most such changes involve technical complexities which would require careful analysis by lawyers. This volume is not an appropriate place to propose them in detail. If there were a central administrative body responsible for continuous improvement of the legislation and procedures that support the competitive policy, one of its functions would be to increase the usefulness of litigation by developing appropriate proposals.

EXISTING DEFECTS: NEGLECT OF DEVICES OTHER THAN LITIGATION

Apart from changes in the conduct of lawsuits, however, there is need to equip the law-enforcement agencies with administrative procedures that reach beyond litigation. The most obvious need is a procedure for rule making. At present many rules of law do not attain general application until they have been exhaustively announced and reannounced in a series of cases brought against individual defendants. A lawbreaker who knows exactly what he is doing is subject to the same procedure and penalties as one whose violation tests a point of law for the first time. In connection with other policies of government, various administrative agencies have been given the right to define the meaning of the statutes they administer by issuing rules which, once successfully defended in court as proper expressions of the law, acquire the status of law. In so far as these rule-making powers consist of rights to elaborate and supplement the law, they are essentially legislative or administrative in character and give the rule-making agency a discretionary authority over those subject to the rules. One of the purpoess of the competitive policy is to minimize such exercises of regulatory control. But in so far as the rule-making power consists merely in the right to clarify and interpret the law, it is quasi-judicial in nature and is no more calculated to extend discretionary control over business than similar exercise of interpretative functions by the courts themselves. Interpretative rules may be used to make the law clearer and apply it faster without changing its content.

To give the antitrust agencies the power to make and enforce interpretative rules would hasten the process of removing ambiguities and determining the application of old principles to new ranges of fact. It would also help expedite action to bring about compliance with the law where unlawful practices are widespread. It is particularly needed for this latter purpose in the enforcement of the Federal Trade Com-

mission Act and the Clayton Act, because, under these statutes, even a defendant who knowingly violates the law cannot now be punished until after he has been personally enjoined from continuing to do so.

An illustration from the law of unfair competition will show how such rule-making power might be used. The sale of candy by lottery methods has been repeatedly held to be a violation of Section 5 of the Federal Trade Commission Act. Under existing procedures, any candy company that has not yet been ordered to stop the practice may make such sales with impunity, regardless of the fact that many of its competitors have been enjoined. Consequently, the commission can make the law generally applicable and provide equal treatment for producers who have already been enjoined only by instituting a large number of separate proceedings looking toward a large number of separate orders to obey the law. If the commission had possessed and used an appropriate rule-making power, individual suits would have been necessary at the outset to establish the illegality of the practice. Thereafter, the commission might have promulgated a proposed rule, declaring such lotteries unlawful throughout the candy industry; and, after hearing, the commission might have put candy manufacturers on notice of the rule, thereby subjecting them to obligations and subsequent procedures for violation of the rule similar to those now invoked by a cease and desist order. It would have been necessary to permit any person who might later be sued for violation of the rule to contend that the rule did not accurately reflect the law; but even where such a claim was made, one lawsuit would have done the work of two. And once this point had been raised and settled in early cases, subsequent proceedings to prevent candy lotteries might have been limited to punitive proceedings against violators, without prior individual injunction and without argument over the meaning of the broad language of the statute.

The need for rule-making powers has been informally recognized by the FTC, which has established a procedure for formulating and publishing so-called "trade practice conference rules." [16] Under this procedure, proposed rules are submitted by industrial groups, subjected to public hearing, appropriately modified, and then promulgated by the commission. The rules are divided into two groups, of which one purports to prohibit practices which the commission regards as unlawful under the general provisions of the antitrust statutes and the other

[16] See Federal Trade Commission, *Rules, Policy, and Acts,* May 21, 1938, pp. 18-21.

purports to contain rules of conduct which, though not legally mandatory, are regarded as desirable and legally not objectionable. The rules have had substantial usefulness in codifying the meaning of trade terms and in various other similar ways. However, since the whole procedure lacks statutory authorization, promulgation of the rules does not shorten nor simplify subsequent proceedings to enforce the law. In spite of this limitation, the commission is careful to reject rules that might raise any question as to legality or propriety, and through an excess of caution the effectiveness of the trade practice conference is sometimes unduly circumscribed.[17] Moreover, such conferences are held only when they are requested by the members of an industry. It would be more appropriate to develop rules defining illegal conduct whenever there is a public need, whether or not any trade group chooses to propose the venture.

Apart from the conduct of litigation, little has been done toward systematic administration of the competitive policy. The antitrust agencies exercise limited functions in preparing and criticizing proposed legislation, but neither of them has undertaken to formulate a comprehensive legislative program based upon adequate research. In his capacity as the administration's law officer, the Attorney General reviews legislation, and through him the Antitrust Division of the Deartment of Justice has an opportunity to comment upon bills that affect the antitrust laws. The FTC is given an opportunity for such comment when the Congressional committee handling a bill believes that the interests of the commission are affected. Each agency, however, is required to submit its proposed comments to the Bureau of the Budget and receive an assurance that they are consistent with the policy of the President before the comments may be transmitted to Congress. Since there is no procedure for bringing the views of the agencies systematically to bear upon the formulation of the President's policy with reference to matters affecting competition, the effect may be to deprive Congress of comment from those best informed. Moreover, the positions taken by the two enforcement agencies are not usually coordinated with each other. Neither is it certain that either agency will have an opportunity to express itself if the legislative proposal does

[17] This caution has been enhanced in recent years by the fact that during the early history of the trade-practice-conference procedure the commission permitted the promulgation of certain rules which appear to have had anticompetitive effects. In 1933 to 1934 these rules were systematically reviewed and amended. Apparently the commission is determined to avoid any similar laxity in the future.

not directly involve enforcement of the law against private restraints. Whether such an opportunity arises depends upon the discretion of the committee handling the bill rather than upon the initiative of the agency.

Similarly, both agencies have an opportunity to initiate legislative proposals, though the Antitrust Division may do so only after receiving the Attorney General's approval. However, when these proposals are concerned with aspects of the competitive policy other than prevention of private restraints, there is usually a feeling, both in the administration and in Congress, that the agency is meddling in affairs which do not directly concern it.

The Attorney General has no authority to undertake research appropriate to legislative proposals. The FTC maintains an economic division and is equipped with broad powers to require factual reports from corporations.[18] Originally these powers appear to have been used both as a basis for developing policies to guide the commission's legal proceedings and as a basis for recommendations that Congress amend the Federal laws.[19] In recent years, however, the commission has undertaken relatively few ambitious economic investigations except at the specific direction of Congress or the President, and its legislative recommendations have been scattered and uncoordinated. Neither the commission nor the Antitrust Division has undertaken the function of continuous planning for legislation on a scale appropriate to the competitive policy as a whole. Nowhere else in the government is there any approach to such planning.

The development of safeguards to replace competition in regulated areas has been wholly haphazard. The sponsors of particular regulatory legislation have included in their proposals such substitutes for competitive safeguards as they happened to think desirable. In some cases they apparently have made no effort to ascertain how similar problems had been dealt with in systems of regulation previously adopted; and there has been neither similarity nor orderly evolution in the safeguards adopted under successive regulatory statutes. Although the antitrust agencies have usually been given opportunity to comment about proposed new regulatory activities, their work has not equipped

[18] See Federal Trade Commission Act (Public No. 203, 63d Congress, as amended by Public No. 407, 75th Congress), 38 Stat. 721 (15 U.S.C.), par. 46, Sec. 6 (a) and 6 (b).

[19] See *Annual Report* of Federal Trade Commission, 1917, pp. 29-30; also *Annual Report,* 1919, pp. 47-48.

them to make authoritative recommendations about methods of regulation, and their place in the governmental hierarchy has not been high enough to make their comments effective, particularly when regulatory proposals have had the backing of Cabinet officers.

Application of the regulatory safeguards has usually been entrusted to the various agencies responsible for regulation. In so far as these safeguards consist of affirmative duties to set levels of price or service, review and approve consolidations of business, and the like, the union of these duties with other regulatory activities is almost inevitable. In some cases, however, the safeguard consists in administrative discretion to prosecute, enjoin, or deprive of exemption from the antitrust laws activity that is regarded as unduly oppressive of consumers or competitors or that restricts commerce in ways not sanctioned by the regulatory law.[20] The practice has been to assign to the regulatory agency responsibility for administering such safeguards also. There is a clear and sustained record of inaction in applying safeguards of this type.[21] Presumably it has been due to the fact that the philosophy and experience of regulatory agencies are as inappropriate to this kind of work as are the experience and philosophy of the antitrust agencies to ordinary regulation. The protection given to the public interest by this type of safeguard could be greatly increased if responsibility for applying it were given to officials who were also responsible for preventing ordinary private restraints.

There has been little or no coherent effort to make the competitive policy influential in the ordinary administrative activities of govern-

[20] For example, under Section 2 of the Capper-Volstead Act the Secretary of Agriculture is authorized to take action against any association created under the act if, in his opinion, the association is monopolizing or restraining trade "to such an extent that the price of any agricultural product is unduly enhanced. . . ." (Act of Feb. 18, 1922, 42 Stat. 388, 67th Congress, 2d Session.) Under the Agricultural Marketing Agreements Act of 1937 the Secretary of Agriculture is authorized to enter into marketing agreements with producers, processors, and associations of producers. Such agreements are exempted from the antitrust laws, and the Secretary is empowered to require reports and such other additional information as is necessary to determine whether any such agreements are being used to abuse the exemption, with corresponding authority to correct such abuse (Act of May 12, 1933, 48 Stat. 31, as amended and reenacted by Act of June 3, 1937, 50 Stat. 246, 75th Congress, 1st Session).

[21] In April, 1947, the Department of Agriculture informed the writer that the Department had not made any formal investigation of activity under agricultural marketing agreements and had not taken any compliance action.

ment. Within a single government agency the head of the agency is responsible for coordinating the work of his subordinates. Interagency coordination among the departments is a function of the Cabinet, and among the newer nondepartmental agencies a function of newly appointed assistant presidents and of various emergency offices and committees of coordination. By such coordinating devices, coherence is sought among the policies of each agency and efforts are made to reconcile conflicts of policy between agencies. However, since there is no agency responsible for the competitive policy as a whole, the various parts of this policy cannot be coordinated. Moreover, the policy as a whole cannot be coordinated with others and has no high-level spokesman in the development of governmental programs. The FTC operates as a thing apart, in closer touch with Congress than with other parts of the administration. Although the Attorney General is responsible for the work of the Antitrust Division, he is primarily the government's chief law officer and is unlikely to make the competitive policy his principal concern. Moreover, the administrative responsibilities of his department do not extend beyond the prosecution of private restraints.[22]

With this type of organization, it is inevitable that many officials throughout the government are scarcely aware of the antitrust laws and are unconcerned to support the competitive policy. When differences of opinion develop between the antitrust agencies and other portions of the government, they usually are not perceived until the point of view of each agency has hardened into action and the two lines of action have come in conflict. Thus members of the ICC may be offended because the Antitrust Division prosecutes railway officials for rate conference activities which Interstate Commerce commissioners have encouraged;[23] or the Department of Justice may be embarrassed in a prosecution by the fact that officials of the Department of Agriculture have participated without legal authority in formulating a marketing arrangement which appears to be a violation of the antitrust laws.[24] Where anticompetitive government action gives rise to no pri-

22 Although he represents certain regulatory agencies before the courts, he does not control the policy of their litigation, much less their other policies.

23 See, for example, Department of Justice Exhibit No. 26 (H-V), *Hearings* before the Senate Interstate Commerce Committee, 78th Congress, 1st Session, on S. 942 (Regulation of Rate Bureaus), May, 1943, Part 1, pp. 270-278.

24 In *United States v. Dubuque Cooperative Dairy Marketing Association*, Cr. 5714, an indictment (Northern District of Iowa, Apr. 24, 1942) under Section 1 of

vate restraint that can be prosecuted, it is likely to remain unchallenged and its conflict with the competitive policy is likely to be ignored. Within the last few years the Antitrust Division has, on occasion, requested permission to be represented in a proceeding before a regulatory agency in order to present views as to the decision by that agency which would be consistent with the competitive policy.[25] However, this device can be used only where decisions are made after public hearing, and even in this class of cases it is slow, expensive, inflexible, and likely to develop conflict rather than agreement.

Experience with coordination at working levels has shown that these difficulties can be overcome. Officials of the government are aware of and, for the most part, responsive to their duty to respect the laws of the United States and to conform to its policies. Hence they are likely to keep their actions reasonably consistent with the competitive policy in so far as they have it in mind.

An illustration is at hand in the development of governmental programs with reference to international cartels. Interest in the subject began in this country with a series of antitrust cases instituted by the Department of Justice. These were soon supplemented by Congressional hearings at which certain facts about international cartel arrangements were presented. The Department of State became interested in the cartel problem because of concern to eliminate enemy trade during the Second World War and because of interest in the terms of postwar international commercial policies. An interdepartmental committee was sponsored by the Department of State, and through this committee the significance of international cartels became evident in connection with a wide variety of government decisions. Consideration of the cartel issue proved to be appropriate to the policies of the alien property custodian in the seizure and disposal of enemy property

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the Sherman Act was returned against the marketing association, the Beatrice Creamery Company, the Sanitary Milk Company, and five individuals. The defendants were charged with conspiring to fix prices for milk higher than the minimum prices for sale of milk by producers to handlers under a marketing order established by the Secretary of Agriculture. An official of the Department of Agriculture testified that, although not formally authorized by the Department, he had advised the defendants to fix prices. The defendants were subsequently acquitted.

[25] For example, see Antitrust Division petition, Nov. 29, 1941, before the Interstate Commerce Commission in Atlantic Coast Line Railroad Application, Docket No. MC-23942. See also Antitrust Division petition to intervene before the Civil Aeronautics Board in the matter of certain contracts between Railway Express Agency, Inc., and All American Aviation, Inc. *et al.*, Docket No. 325, May 14, 1942.

in this country, the policies of the Department of State toward the seizure and disposal of enemy property by other countries, the policies of Military Government toward business property in occupied territory, the policies of the surplus property agencies of the American government in disposing of government-owned war plants, and the policies of the Department of Agriculture toward programs for the disposal of surplus agricultural products. It also proved to be appropriate to the policies of the commissioner of patents and of the State Department toward arrangements for the international exchange of technology, toward domestic patent legislation, and toward the international patent and trade-mark convention, the policies of the State Department in supporting a proposed International Trade Organization and in encouraging or discouraging various types of commercial arrangements between American and foreign companies, the policies of the Securities and Exchange Commission toward security regulation, the policies of Federal lending agencies toward international development loans, and the policies of the Department of State and of various domestic government agencies toward developments in corporation law here and abroad. The implications of American policy toward cartels were examined with reference to all of these matters, and in consequence the programs of agencies directly responsible for the various types of policy listed above were, in many respects, modified. However, since the coordination took place at the working level, modification was possible no further than the opinions of technical experts could be reconciled. Indeed, in one or two instances programs acceptable to all the cooperating technicians were rejected by certain administrative officials who apparently were indifferent to the cartel policy itself. Since a high-level coordinating committee had been appointed to deal with questions of economic foreign policy, it was possible to reconcile the conflicts thus created when they arose with reference to foreign affairs, but there was no corresponding mechanism for use with reference to domestic affairs.

Very little has been done to make sure that the implications of the competitive policy are brought out in private litigation. The Federal courts are not required to report to any central agency the initiation of private lawsuits that involve the construction of the antitrust laws or any other aspect of the competitive policy. No systematic effort is made to discover and analyze such litigation. Occasionally the Attorney General receives information about particular suits, and occasionally one of these is felt to be of such importance that the court is

requested to allow a representative of the Department of Justice to intervene.[26] Decision whether to grant the request is within the court's discretion; if, however, there appears to be a matter of public interest which is insufficiently illuminated by the contentions of the rival parties, intervention is ordinarily permitted.

Until recently there was no systematic attempt to influence state legislation on behalf of the competitive policy. In the 1930's, however, Federal government agencies became alarmed at the rapid growth of state and local trade-barrier legislation. Information was collected by the Temporary National Economic Committee and by several government departments. A small staff was set up in the Department of Commerce to try to reduce trade-barrier laws. An interdepartmental committee was established to harmonize the activities of the various departments. The interest of the Council of State Governments was aroused, and a Federal staff sought to work with the council to persuade states not to enact new trade-barrier legislation, to identify the most obviously objectionable portions of existing legislation, and to induce state governments to act simultaneously for the repeal of these portions.[27] This work was similar to efforts already in progress to remove objectionable restrictions from building codes by offering to localities fed-

[26] For example, in the rehearing of *General Talking Pictures Corporation v. Western Electric Company, Inc. et al.,* 304 U.S. 124 (1938), the Department of Justice filed a brief on behalf of the government, as a friend of the court. In its brief the Department requested the court to rule that it is illegal for the owner of a patent to market his patented article with a restriction that it be used in a prescribed field only. The question in the case arose in a suit in which the American Telephone and Telegraph Company and its subsidiaries attempted to enforce a provision of a license under which vacuum tubular amplifiers manufactured under A T & T patents could only be used by purchasers for radio amateur reception and radio experimental or broadcasting reception. See Department of Justice public statement, released Oct. 19, 1938. The court ruled that the owner of a patent may legally restrict his license to manufacture and sale of the patented invention for use in one or several separate fields for which it may have use, and may exclude the licensee from other fields (p. 125). Further rehearing was denied by the court on Jan. 3, 1939 (305 U.S. 674).

[27] See The Council of State Governments, *Trade Barriers among the States,* Proceedings of the National Conference on Interstate Barriers, April 5-7, 1939. See also statement of Paul T. Truitt, chairman of the Inter-Departmental Committee on Interstate Trade Barriers, Department of Commerce, before the Temporary National Economic Committee, *Final Report and Recommendations,* pp. 336-346; and Paul T. Truitt, "An Outline of Certain Factors in the Study of the Interstate Barriers Question," Department of Commerce, January, 1941.

erally sponsored model building codes.[28] To strengthen the attack upon building code restrictions, the Antitrust Division of the Department of Justice announced its willingness to assist private litigants in attacking restrictive features of such local codes.[29] Consideration was given to the establishment of a standing committee on trade barriers, to be composed partly of members of Congress and partly of members of state governments.[30] Most of these developments were cut short by the outbreak of war. However, expressions of alarm by Federal war agencies about the probability that local trade-barrier laws would reduce the effectiveness of war production led to emergency action by many state governments to set aside the most obviously restrictive features of their laws during the duration of hostilities.[31] Hopeful as these beginnings have been, it is noteworthy that they have taken place piecemeal, without a central formulation of policy, even toward trade barriers, and without coordination with other aspects of the competitive policy.

In recent years there has been no systematic effort to bring about

[28] See G. N. Thompson, "The Problem of Building Code Improvement," (Winter, 1947, *Law and Contemporary Problems,* Vol. 12, No. 1), pp. 97-98.

[29] See Corwin D. Edwards, Central Housing Discussion Papers, G: 1940 Series, *Restraints in Building Codes,* p. 7. See also address by Corwin D. Edwards before the Real Estate Board of Baltimore, Md., Jan. 4, 1940, "The Place of the Anti-trust Laws in the Revival of Building," pp. 6-7.

[30] See "Recommendation from the Department of Commerce to the Temporary National Economic Committee Relating to the Proposal by the Council of State Governments That Congress Establish a Joint Federal-State Committee on Inter-Governmental Relationships," *Final Report and Recommendations of the Temporary National Economic Committee,* pp. 353-355.

[31] In early May, 1942, President Roosevelt formed a committee to work with the Executive Committee of the Governors' Conference in formulating solutions to the problems created by what the President termed "divergent State laws and regulations [which] are impeding many phases of the war effort." The committee included the Secretaries of Commerce (chairman) and Treasury, the Attorney General, the Under Secretary of War, the Assistant Secretary of the Navy, the Chairman of the War Production Board, the Director of the Office of Price Administration, the Director of the Office of Defense Transportation, and the Chairman of the War Manpower Commission. See Department of Commerce news release, May 19, 1942.

A meeting of this committee and the Executive Committee of the Governors' Conference was held on May 20, 1942. Secretary of Commerce Jones announced that one result of the meeting was an agreement by all forty-eight states relating to uniform minimum standards and reciprocal license arrangements with respect to motor transport for the duration of the emergency. See Department of Commerce release, June 2, 1942.

cooperation between Federal and state governments in the enactment and enforcement of antitrust legislation. No model state antitrust statute has been offered to state governments as a basis for legislation. No unified study of the administration of state antitrust laws has been carried on. Proposals that state and Federal governments cooperate in prosecuting particular restraints of trade have been sporadic and have usually originated in the states rather than in the Federal government. The Federal antitrust agencies have remained inactive even when state governments were considering bills designed to sanction various types of restraints inconsistent with the antitrust laws. For example, there was no intervention, formal or informal, in opposition to the enactment of state laws that legalized compulsory enforcement of resale-price-maintenance contracts in most states.[32] In 1945 the application of the Federal antitrust laws to insurance companies was temporarily suspended to permit the states to modify their insurance legislation, and provision was made that where the state undertakes to control restraints of trade, exemption from the Federal antitrust laws shall be permanent.[33] Nevertheless, no Federal agency undertook to influence state governments as to the way in which they might modify their insurance statutes.

In summary, there is no large-scale, sustained, and reasonably coordinated effort by the Federal government to assume four out of the six types of responsibility which are appropriate to a vigorous competitive policy. The maintenance of competition in the United States has been allowed to consist primarily of enforcement of the antitrust laws, supplemented by a substantial amount of unplanned and uncoordinated suggestion about ways in which these laws should or should not be modified.

[32] In hearings before the TNEC the writer, then employed by the Department of Justice, replying to a question of Senator Tydings relating to resale-price-maintenance laws, said: ". . . the function of the Department of Justice does not involve recommendations to the States as to State legislation. Consequently, necessarily my expression of opinion as a person and as an employee of the Anti-trust Division is directed toward such Federal action as we should like to see. If it were pertinent for me to appear in a different tribunal, speaking as to the policy of my native State, it would then become quite pertinent for me to express a point of view toward State legislation." *Final Report and Recommendations of the Temporary National Economic Committee,* p. 155.

[33] Public Law 15, 79th Congress, 1st Session, approved Mar. 9, 1945.

THE NEED FOR CENTRALIZED RESPONSIBILITY

To offer a complete blueprint for an administrative reorganization is seldom useful even where it is possible, for the exigencies of government outstrip the foresight of planners. Moreover, a blueprint for administration of the competitive policy demands knowledge of governmental techniques and relationships which can come only from a pooling of information and ideas. However, the principal needs are clear, even though the exact devices are not.

The first need is establishment of a government agency that carries full responsibility for developing and applying the policy of competition. This agency should perform all six types of function which have been discussed. It should investigate, prosecute, propose remedies for restraints, and watch the effectiveness of the remedies. It should maintain a continuous study of existing and proposed legislation in order to advise Congress on particular bills in the light of a general legislative program. It should assume a substantial responsibility for the content of regulatory safeguards which replace competition and, where there is no compelling reason to the contrary, should administer these safeguards. It should maintain a system for reporting private litigation, and it should intervene actively where *amicus curiae* proceedings appear to be desirable. It should maintain continuous liaison with state governments and should provide active leadership in developing models and standards for state legislation on matters affecting competition. Through its chief officials, who should function at a high level, as well as through committees at the technical level, it should persuade other government agencies to exercise their discretion in ways consistent with the competitive policy.

There are undoubtedly some dangers in such a proposal. At present the agencies that enforce the antitrust laws are relatively well defended against political pressures. As a bipartisan body whose members have a staggered tenure of office, the FTC cannot be easily controlled by any single political machine or national administration. As part of a great law office, the Antitrust Division of the Department of Justice is protected by the strong tradition that prosecutors should play no favorites, adopt no policy, and enforce the law as they find it impartially. The fact that litigation is divided between these two differently organized bodies makes it peculiarly difficult for powerful interests to prevent enforcement of the antitrust laws. Such bits of competitive policy as go beyond enforcement are even more decentralized and are, there-

fore, difficult to attack. If there can be no strong application of the competitive policy under such a system, neither can there easily be a complete abandonment of it. Elements of such a policy are likely to be irrepressible even under the most hostile administration.

This type of strength through weakness would disappear if authority were centralized. The head of the responsible agency would have power to build his program solidly or to scuttle it, and the political influences that focus upon competition would be able to make themselves felt at a central point. If anticompetitive forces became strong, much might be lost.

Nevertheless, the risk should be taken, because it is indispensable to the effectiveness of the policy itself. Earlier chapters have demonstrated that the present law, enforced by present methods, can reduce illegal collusion to tolerable levels but cannot cope with the power of great business enterprises, with the many devices for restricting entry into industry and access to markets, or with the protean maneuvers to use the state for restrictive purposes. Along present lines the policy of competition is probably capable of delaying the transition to a noncompetitive system, but it is probably not capable of maintaining a competitive system indefinitely. A stronger and more varied attack is necessary to success, even though a calculated risk must be taken.

Assuming that a central agency is desirable, there is need to answer two difficult questions, neither of which can be resolved here.[34] First, what is to be the relation between this agency's control of prosecutions and the prosecuting activities of the FTC and the Antitrust Division? An extreme proposal would be to abolish the present bodies, but this would be unfortunate because of the experience which they have acquired and the zeal which they have generated. It might be possible to make the Federal Trade Commission a semiautonomous part of the central agency. It might be possible to transfer the Antitrust Division bodily to that agency or, alternatively, to give the agency authority to

[34] The recommendations that follow should be compared with those of the President's Committee on Administrative Management (Studies on Administrative Management in the Government of the United States, No. 3, *The Problem of the Independent Regulatory Commissions,* Washington, D.C., 1937, pp. 23-28) and of the Brookings Institution, Washington, D.C. (*Investigation of Executive Agencies of the Government, Report to the Select Committee to Investigate Executive Agencies pursuant to Senate Resolution No. 217;* No. 10, *Report on Government Activities in the Regulation of Private Business Enterprises,* 75th Congress, 1st Session, 1937, pp. 61-102).

formulate prosecution programs and possibly to initiate action, while assigning to the Antitrust Division the duty of trying the cases. These are matters for administrative and legal technicians. What is important is that the two enforcement agencies should be responsive to a common policy and that their prosecutions should be coordinated with other types of action.

A second difficult problem arises because of the proposal that the central agency have authority with reference to safeguards substituted for competition. It is desirable that these safeguards be coordinated both with one another and with the competitive policy. It is also desirable, for the sake of the coherence of regulation itself, that broad general purposes and principles pervade the entire body of governmental regulatory activities. These ends might conceivably be served by taking steps to bring the various agencies regulating parts of commerce into the central policy agency as separate divisions or semi-autonomous commissions. The result would be a government agency of unusually large scope and importance, comprising, in addition to the antitrust agencies, the regulatory commissions and certain regulatory bureaus of the government departments. In breadth and in focus such an agency would resemble the ministries of economics that are common in European governments.

This step is so bold, and entails so many partly unforeseeable consequences as to the nature of regulation and as to the balance of forces within the government itself, that one hesitates to recommend it. A more modest proposal would be to give the central agency authority to undertake the investigations and prosecutions appropriate to the regulatory safeguards substituted for those of competition and to let it share the power to formulate safeguards, study their effect, and propose their modification. Under such a system, the various regulatory agencies would retain appropriate degrees of autonomy and would themselves apply those safeguards which are administrative in character. However, the central competitive agency would be expected to appraise the protection afforded and to recommend to the various regulatory agencies, and if necessary to Congress, such changes as it thought desirable.

Formulation of administrative devices and determination of the exact division of authority beween the regulatory agencies and the central agency are matters for technical experts. The essential point here is that an equivalent for competition should be sought in regulation

and the steps taken to provide it should be coordinated with the policy of competition.

In spite of gaps in policy and difficulties in administration, the United States is foremost among nations of the world in reliance upon a policy of competition, in the extent of the laws with which it has supported that policy, and in the vigor and power of the administrative agencies created to apply these laws. National differences in the direction and effectiveness of policies toward competition are reflected in the fact that throughout the world the United States is recognized as a country in which technical innovation has relatively little to fear from the repressive forces of vested interest, in which prices appropriate to sale in large volume are understood to be indispensable to national prosperity, and in which the opportunity to launch new business ventures and invade new markets is relatively unobstructed. The proposals in previous pages do not spring from a belief that the American competitive policy has failed of substantial effect. Rather, they represent an effort to measure the great gap that always prevails in human affairs between aspiration and performance. Although the objectives of the competitive policy are better served in the United States than elsewhere, Americans are increasingly aware that the productive power of our industries is not fully used; that the prices of desired products often outrun the purchasing power of would-be buyers; that, though rapid, our technological progress is slower than need be; and that some portion of these difficulties is due to restraints of trade imposed for group advantage. We still have too much collusion, too many trade barriers, and too many inappropriate or unsafeguarded exemptions from the regime of competition. The basis of our competition is threatened by an unprecedented growth of big business. Continuous strengthening of the competitive policy is needed to minimize these defects and dangers.

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